105

# IMPACT OF REGULATIONS UNDER THE REAL ESTATE SETTLEMENT PROCEDURES ACT ON SMALL BUSINESSES



## HEARING

BEFORE THE

## COMMITTEE ON SMALL BUSINESS
## HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

WASHINGTON, DC, JULY 1, 1993

Printed for the use of the Committee on Small Business

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# IMPACT OF REGULATIONS UNDER THE REAL ESTATE SETTLEMENT PROCEDURES ACT ON SMALL BUSINESSES

THURSDAY, JULY 1, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
*Washington, DC.*

The committee met, pursuant to notice, at 9:30 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Chairman LAFALCE. The Small Business Committee will come to order.

This morning's hearing concerns regulations issued by the Department of Housing and Urban Development just prior to the November 1992 election affecting various aspects of the real estate industry under RESPA, the Real Estate Settlement Procedures Act. The regulations permitted certain activities including the pooling of computerized information about mortgage availability and, in some circumstances, remuneration for referrals to providers of settlement services.

RESPA was first enacted by Congress in 1974 to protect consumers from unnecessarily high real estate settlement charges due to abusive practices. Among other things, RESPA prohibited kickbacks or other fees relating simply to the referral of business to providers of settlement services. Congress addressed RESPA again in 1973, adopting certain amendments seeking to clarify the statute and how it should be interpreted.

Over the years, HUD has issued various informal opinions on aspects of RESPA. In addition, HUD published proposed regulations in May 1988. By December of that year, HUD had developed proposals for a final rule on referral fees under RESPA. But the final rule was not promulgated. Then, last November, days before the election, HUD published regulations concerning controlled business arrangements and computerized loan origination systems to become effective in 30 days.

Proponents of the new regulations believe they promote efficiency and enable consumers to gain access to better, faster service. They say the regulations merely reflect the changing nature of the real estate marketplace. Opponents, on the other hand, say the regulations unfairly discriminate against small businesses which are independent providers of settlement services. They maintain that competition will be weakened and consumers will suffer if the regulations are permitted to remain in effect.

There is some interesting news regarding this issue which I would like to report at this time. Late yesterday, we were advised by HUD that very shortly they will be publishing a notice for a public hearing to address a number of issues concerning the regulations that were issued in November. This notice is on file at the Federal Register and should be published by the end of this week or early next.

The issues to be addressed at HUD's hearing include the exemption for employer employee referral fees, the appropriateness of buyers making referral payments under computerized loan origination systems, the provisions relating to preemption of State laws in this area, and the question of whether the provisions calling for disclosure of controlled business arrangements adequately protect consumers.

While HUD's decision to hold a hearing on these issues is one that was arrived at independently from this hearing, I am pleased that HUD appears to agree that the circumstances in which the regulations were promulgated last year raise legitimate questions about whether another look is appropriate. I hope today's hearing can help focus the issues to be addressed during HUD's review of these matters.

Our committee will hear from a panel representing a variety of groups on both sides of this issue, and I look forward to hearing their diverse views. Before introducing our witnesses, though, I would like to ask any members of the panel if they have any opening statements.

I first call upon our distinguished Ranking Minority Member, Ms. Jan Meyers of Kansas.

[Chairman LaFalce's statement may be found in the appendix.]

Mrs. MEYERS. Thank you, Mr. Chairman. Thank you for calling this hearing to examine the impact of the regulations implemented pursuant to the Real Estate Settlement Procedures Act or RESPA on small businesses.

The regulations' prior interest to those represented today were 10 years in the making and just made final by HUD on December 2, 1992. Since then, when the rules were first published in the Federal Register, considerable disagreement, some might say an all-out war, has developed in the real estate industry among businesses who disagree over the regulations' interpretation of controlled business arrangements and computerized loan origination systems.

I am somewhat familiar with this fight, Mr. Chairman, as my home State of Kansas addressed the issue of controlled business arrangements in 1989. The State legislature passed a law which was litigated to the Kansas Supreme Court and upheld that limits to 20 percent the amount of business any title company could receive from referrals pursuant to CBA's.

I am very pleased we have a witness from the great State of Kansas with us today, Mr. Roger Bell from Wichita, to discuss the Kansas statute and how the Federal regulations are causing confusion for States that already had taken some kind of action.

Mr. Chairman, we have a very knowledgeable panel assembled to speak from both perspectives on the RESPA regulations this morning. I commend you for bringing the committee's attention to the issue and look forward to the testimony of all the witnesses.

Thank you very much.

Chairman LaFalce. Do any other Members have any opening statements they wish to make?

Mr. Bilbray.

Mr. Bilbray. Mr. Chairman, I just wanted to compliment you on this hearing. I am very, concerned on this matter, after having read all the preliminary testimony and facts given to me. I know in many areas we have tried to prevent referrals within companies for fees, figuring the abuses are going to be very, serious, especially like physicians to their own laboratories. Yet we seem in this particular area to have gone 180 degrees and encouraged internal referrals but not external referrals.

So I am very concerned about this and anxious to hear the testimony of all the witnesses. Thank you.

Chairman LaFalce. Mr. Ramstad.

Mr. Ramstad. Very briefly, Mr. Chairman, I would like to welcome the witnesses here today. In Minnesota this is a very contentious issue, a very important one. I commend you, Mr. Chairman, for your leadership in calling this hearing. I look forward to hearing from this distinguished panel.

Thank you, Mr. Chairman.

Chairman LaFalce. Mr. Flake.

Mr. Flake. Thank you for holding this hearing Mr. Chairman. Today we convene to explore the ramifications of the RESPA Act of 1974, which seeks to eliminate kickbacks and referrals that unnecessarily increase the cost of real estate settlement services. In communities like the one I represent, this is an extremely critical and important issue. Therefore, I look forward to hearing from the witnesses.

In November of last year, the Department of Housing and Urban Development promulgated rules to execute RESPA in order to prevent kickbacks to real estate brokers for loan referrals. However, there has been much controversy over the provision within the rules that stipulates controlled businesses can pay its employees for referrals to affiliated real estate providers.

This rule has induced controversy because many contend that it is in direct violation of RESPA which seeks to prohibit such direct kickbacks. It is my hope this hearing will uncover the possible detriment that could result from this ruling and how this issue affects small businesses, which are the predominant businesses of the Sixth Congressional District of New York and many other districts of Members of Congress.

Mr. Chairman, Having heard from this marvelous body of witnesses gathered here, I look forward to the testimony and hope we can come to some concrete conclusions with regard to the Real Estate Settlement Procedures Act [RESPA]

Thank you.

Chairman LaFalce. Mr. Poshard?

Mr. Poshard. I ask unanimous consent that an opening statement be inserted into the record.

Chairman LaFalce. No objection, so ordered.

[Mr. Poshard's statement may be found in the appendix.]

Chairman LaFalce. If no other members of the panel have any questions, I think we will get to our witnesses.

Let me ask that all of our panelists this morning to limit their verbal presentations to absolutely no more than 10 minutes, preferably fewer. We will, however, include the entirety of your prepared statement in the record. In the interest of time we would appreciate you limiting your verbal statements.

We go into session today at 10 a.m. The first bill on the calendar is the Commerce, State, Justice appropriations bill. One of the first amendments up will be a Mr. Penny amendment trying to delete all the money from the SBA save for disaster loans. I would appreciate the assistance of the members in both sides in defeating that amendment or amendments that may be offered.

As a matter of fact, if we get to that point in time where the amendment is offered, I may well have to recess the deliberations of this committee so we can go to the floor to defend that.

Let me read you a bit about all the witnesses. Mr. Howard Birmiel will be a first witness. He is an attorney in Northern Virginia. He is an independent provider of settlement services. He serves as the chairman of CRISIS, which stands for the Coalition to Retain Independent Services and Settlements. He is very much opposed to the HUD rule.

Mr. Terry Rowland will then follow, vice president and general manager of Prosperity Mortgage Corporation, a subsidiary of Long & Foster. Like our previous witness, Mr. Rowland is based in Northern Virginia. He is here as a representative of the Real Estate Services Providers Council and is very supportive of the rule.

Mr. Roger Bell, president, Security Abstract & Title Co., from Wichita, Kansas. That is not by coincidence that a Representative from Kansas is here today. Both Ms. Danner and Mrs. Meyers were very, very interested in that Mr. Bell appears in his capacity as a representative of the American Land Title Association of which he was President in 1978 and 1979. Mr. Bell is very opposed to the rule.

We will then have Mr. Pall Spera, a realtor from Stowe, Vermont. Mr. Spera owns his own firm and comes to us today as a representative, though, of the National Association of Realtors. He will be speaking in favor of the rule.

Then we will hear from Herbert Tasker, representing the Mortgage Bankers Association of America. Mr. Tasker is chairman and CEO of All Pacific Mortgage Co., of Concord, California. He will be speak against the rule promulgated by HUD.

Last we will hear from Mr. Ray Sims, senior vice president of GE Capital Mortgage Services. Mr. Sims works out of Cherry Hill, New Jersey. He will describe for us GE's new national program intended to extend mortgage availability into underserved communities throughout the country. He will be speaking in favor.

So we have a distinguished and a very balanced panel. We will first hear from Mr. Birmiel.

## TESTIMONY OF HOWARD A. BIRMIEL, ATTORNEY, CHAIRMAN, CRISIS, BURKE, VA; ACCOMPANIED BY JOEL HOLSTAD

Mr. Birmiel. Good morning, Mr. Chairman and members of the committee. My name is Howard Birmiel. I am a real estate attor-

ney and title company owner in Northern Virginia and a principal of CRISIS, the Coalition to Retain Independent Services in Settlements. We are a group of settlement and title agents, attorneys and independent escrow companies whose businesses stand to be greatly harmed to the point of extinction following the promulgation of HUD's new rules of the RESPA.

I also have behind me Joel Holstad from the State of Minnesota who has lived with, and is intimately familiar with, the controlled business issues on which I speak. He has submitted a written statement which I will ask the committee to consider.

Chairman LaFalce. Without objection.

Mr. Birmiel. We appreciate you holding this hearing to hear the issues. Our coalition has aligned with it, in our positions against controlled business in the real estate settlement services industry, the Mortgage Bankers Association, National Association of Mortgage Brokers, Consumer Federation of America, Independent Insurance Agents of America, Savings and Community Bankers Association, Ahmanson Mortgage, American Land Title Association, California Escrow Institute, Florida Association of Independent Title Agents, Independent Land Title Association of Minnesota, and other groups.

The latter three State groups have been living with and somewhat dying from the controlled business scenarios which HUD now promotes with a fervor, about which Mr. Holstad can speak from experience.

First, some background to explain. Let me start with the certainty that small, independent competition in the unique settlement and title insurance markets keeps prices down and consumer interests at hand.

What are the steps in real estate settlements? First, the realtor writes the contract for the house purchase. The purchaser applies for a loan. He may go to a mortgage lender or broker. The appraiser gets involved. Then the process moves on to the settlement or escrow agent. The title search is performed, title examination is performed. The conveyance documents are prepared and processed. The contract terms are carried out. There is a surveyor involved. The termite inspection. The home insurance is selected. All of these are settlement providers involved in the process.

How does the purchaser get referrals for each of these functions in buying a home? The realtor refers the purchaser to the mortgage lender and to the settlement agent. The realtor is, by far, the most important entity in the referral of settlement business. The consumer relies upon, generally, and trusts his realtor in most cases, not every case but in some cases.

Despite all of the disclosures that the entity is an affiliate of the real estate company, the consumer is going to take that realtor's suggestion out of the trust of the personal relationship and not as a matter of convenience. He relies on his realtor to tell him how the process is done.

A lender referral also can be made to the settlement agent. These services are performed by small businesses. They work well because they are independent; they keep the consumers' interests in mind. Referrals from realtors and lenders, for the most part, have been made based on price and quality of service provided by

small businesses, including mortgage lending, and settlement agents.

RESPA was enacted in 1974 in response to evidence of kickbacks in the mortgage and settlement referral process. Realtors or lenders would be paid kickbacks for referral of settlement service business, which business was referred for the self-enrichment of the realtors. There were newspaper articles by Ron Kessler in The Washington Post. Certain Members of Congress were made aware that they, too, were paying more due to kickbacks being passed on to the consumer in the mortgage lending and settlement process.

RESPA prohibits the payment of kickbacks, referral fees, and things of value in connection with referral of settlement services. It worked well to clean up the industry and keep the various services independent for the consumer. The home purchase for the consumer, generally, is the largest transaction the consumer makes in their life.

I pulled out of a drawer the special information booklet I got from HUD in 1975 when I started my practice in real estate. I started reading: "For many people, buying a home is the most significant financial step of a lifetime. The RESPA act helps to protect you. While real estate brokers help to provide advice and may, in some areas, supervise the settlement, in most instances, they serve the seller and not the buyer."

Over most of the 1970's and 1980's, realtor ethics prohibited steering of settlement business; the realtors in my area were cautioned to make certain that they gave three names of settlement service providers.

What happened in 1983? The realtors obviously wanted to own mortgage and title operations and be protected from antikickback provisions. They wanted new profit centers. The 1983 Controlled Business Amendment, Section 8(c)(4), provided that referrals to an affiliate in which the referring company had at least 1 percent ownership interest were OK, as long as the only thing received in return was a return on investment from the referring entity. The use of the affiliate was not a required use, and the disclosure of the referred company's affiliation was made to the buyer.

Congress could not have imagined the potential proliferation of schemes to steer business, some then legal, some perhaps not, which it was now creating at the urging of large real estate entities.

Thus began the advent of self-referrals in the real estate industry. Some States recognized these controlled business permissives were devastating to small businesses and consumers, and were able to enact restrictions on controlled business and referrals, limiting the amount of controlled business that could be done by affiliates, requiring them to compete in the marketplace as well. These affiliates cannot compete with independents in the absence of captured referrals. HUD and the real estate industry now attack these State laws, calling them anticonsumer.

The growth of controlled business was most rapid in Southern California, Florida, and Minnesota. It is a consumer detriment. The referral of mortgage and settlement business has, in large part, become based in a new profit center to be derived for the real estate entity doing the referring, instead of price and quality of

service provided, which has been the basis for referral in the absence of these new businesses by the realtors. Without HUD's regulations, the smaller real estate businesses in the country had not yet figured this out.

What incentive is given to the agent to make the referrals to the company's affiliate, legal or illegal, and to play the company line in keeping referrals with in-house affiliates? For the last number of months I have been finding out.

Lower desk fees. E&O insurance is paid by the broker. You get higher commission splits if they go with the company referral. Withholding the buyer referrals from real estate agents not going with the company program. Setting of office quotas for numbers of mortgages and closings referred to affiliates. Payment of agent's final commission early at their settlement if they refer the buyer to their affiliate's closing service.

We provided documentary evidence that all of these have developed since the 1983 amendments. In the large realty company scenarios these business steering practices are happening rapidly. They particularly proliferate in the larger real estate companies in the States I have mentioned to keep the business in-house.

When the real estate agent makes a referral to its companies' title or mortgage affiliate now based on self-gain of the realty company rather than the price and quality of the service, as would be the norm in an environment free of kickbacks, the consumers' interests are left to the wind. The independent providers of loan and title insurance are driven out of the marketplace. They cannot——

Chairman LaFalce. Mr. Birmiel, it has been suggested to me that perhaps if you could bring the microphone a bit closer, we could hear you a bit better.

Mrs. Meyers. I see some people in the back of the room who may be having some trouble hearing you.

Mr. Birmiel. The independents could, however, under the present regulations, sell out a part of their business to the realty company so the real estate entity could receive its return on investment permitted by the statute.

The system of checks and balances created by the 1974 act, which kept the elements of the settlement services businesses distinct and independent, where they could look out for the interests of the consumers without undue pressure to make a loan or close the transaction, began to wear away; this happened in the interests of new real estate and lender in-house profit centers, which these lending and title closing affiliates would provide.

The RESPA enforcement unit was created, I believe, in 1991, to take complaints from consumers regarding RESPA violations including those involving kickbacks and incentives to agents for referral of business. The expectation was that a volume of a few hundred complaints per year would be received from consumers. The complaints filed ran quickly into multiple thousands as myself and other competitors of the abusers vented their years of frustration.

The unit was quickly inundated, evidencing that substantial kickback problems and both legal and illegal attempts to control business referrals abound.

This is documented in anecdotal evidence from competitors of the offending businesses, and in newspapers articles involving ille-

gal incentives, again in the California and Minnesota areas. They strangely resemble the 1974 kickback practices.

What happened on November 2, 1992, the day before the election? In 1988, HUD had issued draft regulations for implementing the controlled business amendments. Hearings were held in 1990. Substantial controversies existed. They were rewritten. Additional drafts began to surface, even as late as 1991. On November 2, HUD published final regulations, effective in 30 days, containing a recipe to the real estate and lending industries on how to create your affiliate and refer business to it.

Documented evidence shows a political decision made at HUD to encourage the growth of affiliates. The regulations provide referral fees can be paid to employees of real estate companies and lenders for the referral of mortgage and settlement service business to affiliates. We call them kickbacks.

I understand that, at early hearings, the real estate industry represented they needed referral fees in order to get their employees to refer the business to their affiliate.

Realtors who typically represent the seller could now act as loan originators, take loan applications, charge consumers fees, and act to obtain loans to the buyer in the alleged interest of greater choice for the consumers. The realtors as loan originators could then be paid fees by the lenders, a portion of the money earned by the lender.

I will defer to the representatives of the mortgage bankers who will explain in more detail about this controlled business conflict. How are these justified by the proponents of one-stop shopping? They promote consumer convenience. The consumer can go in the front door of the real estate office; he never comes out, under the scenario. The largest transaction of his life is made in a conflict-laden system in which the realtor's commission, the affiliated lender's profits, and the title company's fees all depend upon giving the loan and closing the deal. Who is looking out for the consumer's interest?

Lower fees from integration of all the processes of the package of services. Allegedly, the consumer will be charged less from the lessening of administrative costs. Will a discount of $200 on a package of services offset the fact that the nonaffiliated lender down the street may be charging half a percent less, amounting maybe to $1,000 less, for obtaining the loan? The consumer does not get to them because they don't have an opportunity to shop.

The consumer is going to be discouraged from shopping by the realtor whose corporate entity is asking the realtor to keep the business in-house, and this does go on.

This concentration of business with realtor affiliates will destroy independent providers who do not otherwise have to answer to a parent realtor and lender for providing these services. When the controlled business scenarios become control of business as they have in California, Minnesota, Florida, and areas of Pennsylvania, the independents either become part of a real estate office or they are driven out of business. The independent competition suddenly does not exist anymore, and the affiliates are free to charge what they wish.

A few weeks ago, HUD entered into a $700,000 settlement with Coldwell Banker alleging illegal practices in steering purchasers to its affiliated lenders and title affiliates in Minnesota and New Jersey. Although Coldwell admitted to no wrongdoing, we in the business and the real world have observed that in Coldwell offices their business was steered to their own affiliates in large numbers.

It is a simple matter. It is a simple matter of money. The realtors would like to use their profit centers, and they certainly are going to steer their agents in that direction, whether or not their agents can get direct compensation, obviously not, under the regulations.

However, it does fall through; the pressure comes through; the incentives are there as is played out in the States that have advanced prior to the regulations.

Chairman LaFalce. Mr. Birmiel, I am going to have to ask you to conclude your remarks shortly because you have exceeded the 10 minutes.

Mr. Birmiel. I would like to conclude by just going through three scenarios that I have observed.

The larger real estate company has its wholly owned affiliates and advertises one-stop shopping. The consumer walks in the front door, doesn't come out. The independent provider is not allowed to walk past the front desk, not allowed to sell his services to the agents.

The smaller company, Century 21 franchise, cannot advertise a fully-owned affiliate, a fully-owned title affiliate, for example. A title company forms a new title agency, partially owned by the Century 21 broker as an affiliate. The real estate broker has no liability or responsibility for the title operation. For all the business they can refer from their agent, they receive their return on investment. They have none of the liabilities, none of the responsibilities of owning a title company.

Three Century 21 offices in the Northern Virginia area have done this, at least that many since the regulations were enacted; Century 21-Teachers, Century 21-Marie West, and Century 21-Great American.

An attorney set up a broker's title company in which he sold individual shares to real estate agents, and they would own 65 percent of the title agency. He would own 35 percent. His firm would do the settlements. Where does the consumer fit into all this?

As many referrals as these realtors can make, they run their return on investment and profit. This is all illegal according to the 1983 amendments, as I see it. All the consumer has got is a disclosure of the relationship. He is going to get referred to this entity. There is no room for discounting or one-stop shopping. The title company is making less; the realtor is getting a return on the investment.

Look at these entire scenarios, and I believe we have a consumer problem to be addressed. I believe we have a small business problem to be addressed as a result.

Chairman LaFalce. Thank you very much, Mr. Birmiel.

[Mr. Birmiel's statement may be found in the appendix.]

Chairman LaFalce. Our next witness, Mr. Terry Rowland, represents the Real Estate Services Providers Council.

**TESTIMONY OF TERRY ROWLAND, VICE PRESIDENT AND GENERAL MANAGER, PROSPERITY MORTGAGE CORP., A SUBSIDIARY OF LONG & FOSTER, FAIRFAX, VA**

Mr. ROWLAND. Good morning, Mr. Chairman and members of the committee.

My name is Terry Rowland, and I am vice president and general manager of Prosperity Mortgage Corp., a subsidiary of Long & Foster Companies, Inc. Our sister company, Long & Foster Real Estate, Inc. provides real estate brokerage services throughout 13 offices and 6,300 agents in the States of Virginia, Maryland, Pennsylvania, West Virginia, Delaware, as well as in Washington, DC.

Today I represent the Real Estate Services Providers Council, called RESPRO, of which Long & Foster companies, Inc. is a member.

Mr. Chairman and members of the committee, RESPRO welcomes the opportunity to testify on the Department of Housing and Urban Development's final Real Estate Settlement Procedures Act regulation.

RESPA was formed in 1992 by diversified real estate services providers throughout the country, known as controlled businesses arrangements under RESPA, who decided to unite to support a Federal and State regulatory environment that allows businesses to offer one-stop shopping to homebuyers.

Our membership is open to companies of all sizes offering a wide variety of settlement services for homebuyers.

Attachment one to my testimony provides a list of RESPRO's current members, which totals 22; and are still growing. As you can see, our membership is open to real estate brokerage companies, mortgage companies, title companies, and any other service providers of settlement services as defined by HUD under RESPA.

We are all united by one common bond: We want to offer one-stop shopping for homebuyers in a cost-efficient manner through affiliations, joint ventures, and partnerships with companies offering related services.

RESPRO believes that the current RESPA law and HUD's 1992 final RESPA regulation benefit the consumer by allowing our companies the ability to offer these products and services that our customers really need.

After RESPA was enacted in 1974, three fundamental changes in the real estate services marketplace have made it not only desirable but inevitable that real estate settlement services providers establish financial relationships. These are controlled business arrangements, with other service providers in order to offer multiple products and services for homebuyers.

First, homebuyers' demands have significantly changed since RESPA was enacted. As you can see from attachment three, two-income households made up 38 percent of the population in 1974. By 1990 it was 47 percent. The numbers expected to make up 52 percent of total households by 1995. More two-income households mean less time available to spend on the complex home purchase transaction. It means homebuyers want more convenience. They no longer have time nor the desire to go to a real estate broker for brokerage services, a mortgage broker or lender for a mortgage

loan, a title company for title insurance, and so on and so on down the line.

Second, a major change in the marketplace has been the increasingly widespread use of advanced technology in home and in business. The availability of computers, hot lines, fax machines, and other technological advancements enable all settlement service providers to expand their geographic markets, lower their costs through increased efficiencies, tap into capital markets and increase the amount of information and product choice that are available to homebuyers.

Finally, the competitive dynamics of the real estate marketplace have dramatically changed since 1974. The maturation of the baby boom generation has increased supply and decreased demand for residential homes so that more providers of settlement services are competing for fewer customers. As a result, settlement service providers have one or two choices if they want to survive. They can either expand into ancillary services and tap into new markets or they can artificially retain high profit margins by restricting entry into the segmented marketplace by new members.

We believe that the diverse figures or one-stop shopping provides significant consumer benefits such as greater consumer choice, better service, greater competition, and most importantly, lower costs. Studies have shown that when settlement service companies are able to diversify into other services, it results in real cost savings for the consumer.

For example, a 1992 survey of title service costs in the Minneapolis-St. Paul marketplace found that diversified providers charged approximately $13 less per closing for a market basket of title services — including buyers closing, plat drawings, assessment search, name search, and record satisfaction — than the independent providers.

My written testimony contains other examples of actual and potential cost savings from diversification.

Unfortunately, companies have never been able to fully provide the consumer benefits associated with diversification and one-stop shopping because of the confusing Federal regulatory environment over the last decade.

RESPRO supports the statutory framework Congress established in 1983 which established a safe harbor under RESPA for controlled business arrangements as long as: The consumer is provided with meaningful disclosure of any financial relationship between two companies and the normal range of fees charged for the service provided; the consumer is not required to purchase more than one settlement service from one company; and, the only fees paid between providers within the same controlled business arrangement for referrals of business be a return on ownership interest or a return on the franchise relationship.

But for almost a decade, HUD stifled the ability of diversified companies to develop innovative products and services for homebuyers by refusing to issue regulations to implement the 1983 controlled business arrangement amendments to RESPA.

Until the December 2, 1992, final RESPA rule was issued, diversified companies were forced to rely on a series of HUD opinion letters that often reached inconsistent and vague conclusions about

what diversified companies can and cannot offer their customers. Because reputable companies do not want to inadvertently subject themselves to RESPA's criminal and civil sanctions, they were reluctant to offer these products and services that best met the needs of their customers in a changing marketplace. Smaller companies that could not afford expensive legal opinions to provide them comfort in offering new products and programs were at a particular disadvantage in this unfair and uncertain regulatory environment.

Finally, in 1992 HUD issued a final RESPA rule that ended the decade of unclear and inconsistent regulatory guidance for diversified companies as to what is and what is not allowed under RESPA.

RESPRO believes this final RESPA rule recognizes 1983 congressional intent to allow companies to provide consumer benefits associated with diversification.

Significantly, the rule provides that a diversified company may offer its customers multiple products and services at the point of sale; a diversified company may offer consumers discounts or rebates if a customer chooses to purchase more than one product or service from a company; and a diversified company may offer consumer discounts or rebates if the customer chooses to purchase more than product or service from the company; and a diversified company may compensate its management and nonreal estate agent employees for developing and implementing programs involving the cross-marketing of multiple products and services.

HUD's final RESPA rule also follows Congress' intent to provide adequate consumer safeguards against potential abuses when dealing with diversified companies. For example, diversified companies must disclose in writing the nature of any business relationship between any two providers, the estimated charge of the settlement service being provided, the fact that the customer is not required to purchase one product or service to get another, and the fact that the customer may be able to help to get the service at a lower rate by shopping with another company.

A standard disclosure form shown in one of my attachments is provided with my testimony.

A diversified company may not require that customers purchase one of its products or services in order to purchase another product or service.

No affiliate in a diversified company may directly or indirectly pay another affiliate for the mere referral of business.

Providers of multiple settlement services must perform distinct services in return for each payment they receive.

HUD's Regulatory Impact Analysis of the final RESPA rule estimated that the consumer savings from allowing diversified companies to cost-efficiently offer and market multiple products and services for homebuyers at the same time and/or place are estimated at up to $150 per transaction and up to $148.5 million for all homebuyers.

Attachment five to this testimony includes articles that summarize many other significant consumer benefits that flow from HUD's new RESPA rule.

One provision under the controlled business arrangement provisions of HUD's final RESPA rule deserve further discussion be-

cause it has been so misinterpreted by independent providers of services that fear competition from diversified companies.

The new rule provides that RESPA does not prohibit an employer's payment to its own employees for any referral activities. Contrary to much of the publicity surrounding this rule, this provision does not apply to real estate agents which are considered independent contractors and not employees.

We do believe, however, that the ability to compensate managers of diversified companies, which is permitted by the rule, is crucial to the continued existence of diversified companies in the real estate marketplace.

A diversified company that wants to offer one-stop shopping to homebuyers will naturally assign this responsibility to its management. Without the ability to compensate management in accordance with their job requirements, diversified companies would not be able to efficiently offer one-stop shopping for homebuyers.

Chairman LaFalce. Mr. Rowland, I have to ask you to try to conclude your remarks.

Mr. Rowland. I will summarize my comments.

In summary, REPRO strongly believes today's homebuyers and real estate marketplace require a regulatory environment that allows companies to offer multiple products and services for homebuyers at one time and at one place by establishing affiliations, joint ventures, and partnerships with other companies.

By providing settlement service providers with clear and consistent regulatory environment that allows companies to diversify in the most cost-efficient manner possible, HUD's final RESPA rule will increase consumer choice, enhance consumer service, increase competition among providers of services for homebuyers, and lower the costs associated with buying a home.

Thank you for this opportunity to testify. I will be glad to answer any questions.

Chairman LaFalce. Thank you very much.

[Mr. Rowland's statement may be found in the appendix.]

Chairman LaFalce. I have allowed both of the first two witnesses to go not only a bit but way beyond the 10 minutes. But since one was opposed and one was for, it sort of balances out.

For the rest of the panelists I am going to have to be very rigid for the 10-minute rule. With 10 minutes before, we are going to go to the next witness. If you could finish before then, that would be OK, too.

Mr. Bell.

## TESTIMONY OF ROGER N. BELL, PRESIDENT, THE SECURITY ABSTRACT & TITLE COMPANY, INC., WICHITA, KANSAS

Mr. Bell. Mr. Chairman, members of the committee, my name is Roger Bell. I am president of Security Abstracts and Title of Wichita, Kansas. I am here today representing the American Land Title Association.

ALTA has 2,000 members, including title insurance companies, independent title agents, abstracters, and attorneys. ALTA members search, examine, and insure land titles to protect owners and

mortgage lenders in real estate against losses from land title problems.

The typical ALTA member such as myself is a small business operator. ALTA member firms employ nearly 100,000 people over the country and operate in nearly every county of the 50 States.

ALTA believes that there are three principal problems with the RESPA regulations.

First, it is already difficult to compete with the controlled business company. Now, the regulations could be the last nail in the coffin for many independent small businesses such as mine. The root of this problem is the permission granted in the regulations for an employer to pay a bonus fee to an employee for the referral of the consumer's business.

Frankly, we recognize there is a difference with real estate agents as independent contractors. But, ladies and gentlemen, can I tell you, they will be sure that agent is properly compensated.

For example, a real estate brokerage company can pay an office manager or a mortgage lender can pay its own loan originator an incentive bonus or fee to encourage that person to steer business to the controlled title agency.

This aspect of the regulation conflicts with the congressional determination that beyond the payment of bona fide dividends, no other thing of value should be paid or received in controlled business arrangements.

If an independent title agency such as mine made a similar payment to the office manager or the loan originator, it would be subject to criminal and civil sanctions for violating Section 8 of RESPA. Consequently, independent agents find that they are unable to compete.

We agree with the Consumer Federation of America that allowing such payments will determine the direction of referrals. They recognize that there is a great danger that few, if any, consumers will be able to escape the one way highway of financially induced referrals to captive affiliates. I believe that highway is one that leads toward increased prices. Carried to the ultimate conclusion, it will also lead to fewer providers of settlement services.

Our second major concern is the attempt in the regulations to preempt State-controlled business provisions that go beyond the disclosure approach Congress adopted. The controlled business exemption to RESPA was enacted in 1983. At that time, Congress knew that the National Association of Insurance Commissioners was considering requirements that controlled title agencies obtain a significant portion of their business from sources other than referrals from their own controllers.

Consequently, Section 8(d)(6) of RESPA was specifically included to avoid Federal preemption of stricter State-controlled business laws. Congress made this clear in the language of the statute. The committee report also made it clear that RESPA should in no way inhibit the States from adopting such provisions.

Indeed, my own State of Kansas as Representative Meyers mentioned, adopted such controlled business provisions. Yet the RESPA regulations suggest that this law has been preempted.

Going back to Kansas for a moment, in 1986, as a result of consumer complaints, my State insurance commissioner became con-

cerned about controlled businesses in the title insurance industry. He appointed a study group composed of representatives of all segments of the real estate industry. The commissioner then proposed the legislation that this committee recommended. This legislation passed the Kansas legislature unanimously in the State Senate, and with only two dissenting votes in the House, and was enacted. As enacted, it limits the amount of controlled business, in which a title company could engage, to 20 percent of its gross operating revenues. In other words, it forces it to go on the marketplace and compete for its business.

This controlled business legislation has played an important role if preserving competition in our State. Unfortunately, the RESPA regulations raise concerns about Federal preemption. I have heard the same concern has been expressed in other States that are considering such legislation.

ALTA has brought this problem to the attention of the new administration at HUD. We are hopeful they will clarify that State laws in this area that are not preempted.

Finally, the title insurance industry has also raised a number of questions regarding a new concept-core title agent services. This is HUD's attempt to identify the basic services that a title insurance agent must perform to avoid his compensation being viewed as a RESPA Section 8 violation. In other words, he has to do all the things necessary to provide the product if he is going to charge a full rate for that product.

We have seen a number of shell companies in the Kansas part of the enactment of our legislation that were really pass throughs; they had no employees; they contracted with another title company to produce the entire work product at a lesser rate than the going rate. Of course the shell company collected the difference.

We commend HUD on addressing this issue. However, we hope HUD is able to refine the provision to at least take into account the many regional variations in the settlement industry. The business isn't conducted the same over the entire country.

We deeply appreciate the committee's concern about this issue. We hope that the members of the committee express misgivings about the regulations to HUD.

Thank you very much, Mr. Chairman.

Chairman LaFalce. Thank you.

[Mr. Bell's statement may be found in the appendix.]

Chairman LaFalce. Our next witness will be Mr. Pall Spera.

## TESTIMONY OF PALL SPERA, REALTOR, PALL SPERA CORP., STOWE, VT

Mr. Spera. Thank you, Mr. Chairman. I will adhere to your time instructions. Mr. Chairman and members of the committee, my name is Pall Spera. I am a realtor from Stowe, Vermont, and also 1993 Chairman of the Public Policy Coordinating Committee of the National Association of Realtors. I am president of a real estate brokerage firm with 20 realtor associates and two appraisers and represent 750,000 members of the association.

I would like to thank you and the members of the committee for the opportunity to present the views of our members on the De-

partment of Housing and Urban Affairs' final ruling on implementing the 1983 amendments to the Real Estate Settlement Procedures Act. Of particular concern are realtor involvement in the mortgage process through computerized loan origination and the continued ability of our members to participate in diversified financial services, companies known as controlled business arrangements, or CBA's, as Mrs. Meyers as indicated.

My written statement will provide a general statement of support on behalf of the National Association of Realtors for the Department of Housing and Urban Affairs's final rule, effective December 2, 1992, and overview of recent trends in the real estate brokerage industry and implications of those changes for the continued profitable of our industry, a discussion of computerized loan origination and realtor involvement, consumer benefits derived from the point of sale delivery of mortgage-related services, the legislative history of the intent of Congress, and a statement of NAR's policy with respect to RESPA.

Because the focus of this committee is small business, I will attempt to frame the issues in terms of the benefit that HUD's final rule, if left unchanged, will bring to the thousands of small businessmen and women who represent the majority of NAR's membership.

The 1990 median income for brokers was $31,400, while the median income of sales persons is $22,500. Moreover, the definition of a CBA asset by Congress in 1983 is having just over 1 percent ownership interest in a related real estate company or an affiliation by virtue of an agreement to do business together as a common — as is common in family businesses.

The National Association of Realtors commends HUD for issuing a rule that is a victory for consumers while allowing industry growth. It removes the artificial boundaries between different types of real estate services associated with the sale and purchase of a home and allows the real estate professionals to join forces to offer multiple services for homebuyers and sellers at one time and in one place.

We do not expect our members to abandon real estate brokerage as their primary source of revenue. We believe in their right and the right of all individuals to choose how they wish to grow with the industry. Had the final regulations curtailed these rights, both industry and consumers would have borne the cost.

Putting aside the industry turf battles of the past decade and fears of potential abuses that some seem to think will be inevitably associated with change, we believe the discussion should be about the more meaningful issue of how the role of real estate professionals is changing, the forces driving the change, and the competitive tools needed to survive in that transition.

The primary focus is technology and the real estate brokerage industry, but similar arguments could be presented for other settlement service providers as well. The answer for them is the same as it is for us, sir. We will have to change some of our old ways of doing business to meet consumer demand for versatility and better service. Real estate firms in particular will have to diversify their clients and customers and become more conversant with the realm of possibilities available through technology.

The world of the realtor is, indeed, changing. Technological innovations are accelerating at a rapid pace with the advent of integrated technologies, voice, data, video, traditional delivery of real estate is being replaced by new services. In many cases these new technological applications to real estate data offer an efficient, cost-effective, and highly organized exchange of information. The consumers are likewise becoming increasingly aware of the technological opportunities that are available to them.

We are ready to respond to that challenge but cannot do so if shackled by excessive regulatory intervention. Real estate brokerage, especially residential brokerage, will continue to be the most important revenue producer for real estate companies in the future. That is not to say that broker owners will not offer other real estate services like CLO, title, and escrow; but these additional services are not expected to provide more revenue than brokerage services enhanced by computer technology.

Nevertheless, it is critical that real estate firms be allowed to provide a full range of real estate related services. The average profitability of a residential brokerage companies has fallen significantly in recent income, expense, and profits studies conducted by the association. As business costs continue to escalate, real estate firms will be required to achieve profitability through cost containment and diverse figures.

As we have seen computerized multiple listing services take over, the new approaches to real estate information are quickly transforming, our consumers will receive information, including characteristics of home and supporting real estate transaction information and the like. The competitive business climate of the 1990's and the more rapid integration of technology in every day activities may well catapult these systems into full industry penetration by the end of the decade.

The systems included in my written statement offer a new approach to real estate information access and dissemination, pivotal elements in the selling and buying of real estate, the computerized loan origination system has been discussed as CLO involves the placement of a computer or terminal in a broker's office. It provides information about the loan products offered by one or more lenders. It can be used to prequalify borrowers and transmit mortgage applications. Buyers are assisted in the application process by the system operator.

Today there are fewer nationals systems. But as technology becomes less costly, regional and local systems will emerge tailored to the specific needs of individual real estate markets. The CLO system of the future will be open to as many lenders as the system can accommodate, which, essentially, is unlimited.

The only reason for excluding lenders will remain negative experiences with the lender's performance during the funding process of the servicing and mortgaging of the loans.

The computerized loan origination systems extends the services to the realm of mortgage finance. They enable real estate brokers and their agents to keep up with the literally hundreds of basic combinations of loans available to fulfill the needs of their compliance and customers.

In my particular area, the CLO system would provide those rural areas served by one, possibly two financial institutions, with the mortgage products of national lenders bringing much need competition to these markets and increased choices for our consumers.

They are also useful during periods of high interest rates when lenders are less willing to negotiate interest rates. Computerization enables lenders to turn around loan application in as little as a few days when the average time a home buyer waits for a decision on a loan processed manually is more than 30 days. The introduction of streamlined processing has forced all lenders to improve their turnaround time.

For consumers for whom a simple, fast process is of tantamount importance, the coming of age of the mortgage delivery system has been long overdue. The streamlined process lowers transactional cost of obtaining a mortgage through reduced points, fees, interest rates, and/or some of the combinations.

A reduction of a quarter of a point in these transaction points, which is a reasonable estimate of consumer savings, translates into approximately $6,000 over the life of the loan. Additional consumer benefits are included in my written statement.

The National Association of Realtors adopted, through its board of directors, in 1989 that, where a real estate broker or agent provides services in addition to or different from those that he or she is obligated to provide by his or her agency agreement, that broker is entitled to remuneration for those services, provided that full and written disclosure is made and accepted by all clients and customers to the transaction in advance of undertaking to perform such services.

The National Association of Realtors is opposed to the acceptance of fees by real estate brokers or agents for the simple referral of customers or clients to mortgage lenders and providers of other settlement related services.

As we have said, the emphasis is added on that that is commonly referred to as naked or blind referral fees.

The National Association of Realtors does not support further legislative changes to RESPA but would recommend some clarification at the regulatory level. Specifically, it would be helpful to add definitions of computerized loan origination and bona fide employee. We believe this would end some of the controversy surrounding referral fees to independent contractors and additional fees to computer information services that are typically provided free of charge by broker agents representing sellers.

Chairman LaFalce. I am going to have to ask you to sum up now, Mr. Spera.

Mr. Spera. The real estate industry is growing and requires a revolution of mortgage lending to handle that growth. By the year 2000, there will be a demand for $1.4 trillion in mortgage money, 7 to 10 million more people may be buying homes.

The preference for these homebuyers will be to increase the need for alternative mortgages and real estate brokers and agents who can take the buyer quickly and knowledgeably through every step of the transaction.

In our view, we no longer can put a stranglehold on the mortgage delivery system because of an alleged turf war between competing interests.

Denial of the inevitable can be deadly. We have spent too much time fighting each other. We should be joining forces to bring the real estate industry into the 21st century.

Thank you, Mr. Chairman.

Chairman LaFalce. Thank you very much.

[Mr. Spera's statement may be found in the appendix.]

Chairman LaFalce. Our next witness will be Herbert Tasker, chairman of the board of All Pacific Mortgage Co., speaking on behalf of the Mortgage Bankers Association of America.

## TESTIMONY OF HERBERT B. TASKER, CMB, CHAIRMAN, AND CEO, ALL PACIFIC MORTGAGE CO., CONCORD, CA

Mr. Tasker. Mr. Chairman and members of the committee, I am Herb Tasker, chairman of the board, CEO of All Pacific Mortgage Co., I am also serving as president of the Mortgage Bankers Association.

Last December, HUD regulations took effect, which made two significant changes to RESPA. First, those regulations allowed borrowers to pay real estate agents who provided computerized loan origination systems, or CLO's.

Second, those regulations allowed employers to pay employees for referrals where there is an affiliation between different settlement service providers. This is known as the controlled business arrangements.

MBA is deeply concerned over the proliferation of mortgage referral fee programs. People are paying too much for their homes when unnecessary fees are buried within the closing costs. Referral feels inject financial inducements into what should be an open, competitive process.

In 1974, RESPA was enacted to inform buyers about settlement costs and to protect consumers by prohibiting abusive practices, such as kickbacks and referral fees. This prohibition also ensured that the settlement service providers would compete fairly and openly. The principles of RESPA are as important today as they were in 1974.

Our concern is that HUD regulations allow programs that violate these basic consumer protection principles. The spirit of RESPA has been blatantly violated. If steps are not taken to soon revitalize the law, consumers' cost also increase while healthy competition will decline.

By allowing real estate agents to be paid for work performed, a new fee is being added to the transaction. Generally, even where a real estate agent performs work, such as taking an application, the lender must check the information as a quality control or, in most cases, retake the entire application.

Paying for this service only adds more cost. We believe it is a thinly veiled excuse for paying a referral fee.

The real estate agent does not underwrite the loan, have the financial capacity to indemnify a lender for losses due to fraud or

error, or assume the risk if interest rates shift during the loan application process.

Also, by allowing real estate agents to charge a fee for the CLO service, additional costs are added. Realtors have traditionally helped buyers to obtain financing as one of the services provided to the seller. Homebuyers should not have to pay additional fees to a real estate agent for helping find a loan.

The new HUD regulations will encourage adverse steering and will reduce competition. The regulations allow the borrower to pay a fee to the real estate agent for loan information listed on the CLO system. Moreover, the regulation does not define a CLO system at all. It gives no guidance on how many lenders or loan programs must be listed. There is no incentive to design the CLO system to carry loans with the best rates or terms. There is no requirement that the rate information from lenders who are not participating on the CLO be given to the borrowers. Indeed, a lend who wants to have loan information listed on a CLO cannot demand open access to that system.

We are concerned that exclusive CLO arrangements will be established and will restrict consumers' choices. The consumer will be paying for a limited service, and the lenders not on the system will get less business. Limiting competition is not beneficial to the consumers or lenders.

Allowing the payment of a fee to a real estate agent affects the quality control because it jeopardizes the integrity of the credit process. A real estate agent's primary compensation is the sales commission. Allowing individuals with a strong vested interest in seeing a loan closed to become actively engaged in taking loan applications has the potential to seriously compromise the lending decision.

Allowing a real estate agent to collect a sales commission from the seller and a fee from the buyer for the CLO service has tremendous potential for creating conflicts of interest. Many consumers, particularly first-time buyers, are unsophisticated about the steps involved in the purchase of a home. Thus, they look to the real estate agent to guide them through the process. However, the real estate agent has a contractual relationship with the seller — it is to sell the home at the highest possible price within an acceptable time frame.

The buyer and the seller have different and sometimes opposing interests. Liberal underwriting and speedy processing are important to the seller and the real estate agent. But the borrower is more interested in interest rate and points, the monthly payments, and the size of the down payment.

MBA believes that the computerized loan origination systems can be useful to the consumers and to the lending industry. However, we need to protect the consumer and to ensure a competitive marketplace. Therefore, MBA believes that certain controls need to be in place.

Specifically, we believe that multiple lenders must be allowed to list their products on the CLO. The borrower must have adequate disclosure about the service provided and the fees required before committing to pay for the service. The fee must be reasonably related to the value and the cost of the service provided. The borrow-

er must pay the fee at the time that the service is provided, not at the closing of the loan.

In summary, MBA strongly believes that referral fees do not add value. I am concerned that today we are witnessing a return to the pre-RESPA period when consumers were paying unnecessary or hidden fees that increased the cost of home ownership.

Computerized loan origination systems can be beneficial to the home buyer and to the lending industry, but controls must be in place. We should not allow CLO systems to choke off access of lenders to the consumer. We should not allow CLO systems to discourage borrowers from shopping around for the best price because the price of convenience may not be just the fee paid but the higher cost mortgage.

We should not allow lenders who do not participate in the CLO system to be excluded from getting referrals. Without referrals. Those businesses will close and will no longer be a competitive force to keep mortgage rates and real estate settlement costs competitive.

We should not allow HUD to sanction a system that reintroduces the unnecessary fees that were purged by Congress from this Nation's real estate market after 1974. We believe the new administration should carefully review the regulations implemented last December to assess the impact on consumers as well as the impact on the competitiveness of the mortgage lending and settlement services industries. If HUD is not responsive, we urge congressional action.

Thank you, Mr. Chairman, for this opportunity to share my views on this important issue with you and the rest of the committee. We would be happy to furnish any additional information.

Chairman LaFalce. Thank you very much, Mr. Tasker.

[Mr. Tasker's statement may be found in the appendix.]

Chairman LaFalce. Our final witness will be Mr. Ray Sims, senior vice president of GE Capital Mortgage Services, Residential Express Division.

Mr. Sims.

## TESTIMONY OF RAY SIMS, SENIOR VICE PRESIDENT, GE CAPITAL MORTGAGE SERVICES CORP., RESIDENTIAL EXPRESS DIVISION, CHERRY HILL, NJ

Mr. Sims. Mr. Chairman, members of the committee, I am Ray Sims, senior vice president of GE Capital Mortgage Services, Residential Express Division of Cherry Hill, New Jersey. My company is a subsidiary of GE Capital Mortgage Corp., which is involved in many aspects of the mortgage business.

My career has been as a mortgage banker. GE capital mortgage has been an active member of the Mortgage Bankers Association of America. I am pleased to be here to testify on the implications of technology and the Real Estate Settlement and Procedures Act rule.

As you know, the isolation of neighborhoods and the segregation of people from the mainstream of communities is an important aspect of our problem of distressed neighborhoods. Many families in urban and rural areas do not have access to the kinds of services

— including financial services — that the rest of us take for granted.

Often we have found that underserved neighborhoods are not connected to the mainstream mortgage community. At the same time, there are resources in underserved neighborhoods, such as community groups, nonprofits, churches, real estate agents, financial institutions, that can act as ready and willing partners for mainstream participants.

What has GE capital done as a corporation? GE Capital Mortgage is acting as a principal link between the neighborhood and the mainstream mortgage system. We are bringing substantial private sector capital to residents of underserved neighborhoods and communities. In doing so, we have sought to utilize the latest computerized loan origination technology. Indeed, CLO capability is an essential link in our outreach program. A principal reason why I am here today is to illustrate for you how CLO's can be used to bring mortgage services to urban and rural communities which are currently underserved.

We are in the business of helping people buy homes, particularly those who cannot afford a large down payment. The heart of GE capital is one of our country's largest mortgage insurance companies. In that business, we insure lenders in the event that borrowers who buy homes with a low down payment do not repay their mortgage. Without us, many of these families could not qualify for a mortgage.

As my colleagues at GE have worked in urban and rural neighborhoods, they have identified other resources that we can bring to expand the availability of capital.

Mr. Chairman, we have 17 members of the Residential Express Network, 14 of which are minority- or women-owned, including African-American, Hispanic, Native American, Asian, and East Indian institutions. Most of these are smaller banks that were not making residential mortgages only 1 year ago. If they were making loans, they had a very limited product offering that required at least 20 percent down payments. Most of these institutions were not connected to the mainstream mortgage system or the secondary market because they lacked the resources and/or the expertise.

Since writing this testimony, I can add, over the weekend Unity Bank in Texas has joined our network. Yesterday, through overnight mail, Gateway Bank in Missouri, the only minority bank in that State, is now part of the GE network. Of these banks, 12 of the 17 have already originated loans.

The banks that have joined the network move quickly to serve the unmet needs in their communities. The remaining institutions, quite frankly, are just waiting on our training program. Residential Express provides a source of fee to the lenders while helping retain their customers and potentially expanding their customer base. These are very important economic considerations for community and minority lenders.

Briefly, here is how Residential Express works at GE. When a financial institution joins, we will train the lender's staff at their site. The computer program performs almost every function you can imagine. It electronically provides loan prequalification, application analysis, immediate feedback on underwriting decisions, and

daily mortgage rate information. It provides a tremendous variety of mortgage information to homebuyers on interest rates, points, down payments, and repayment schedules, importantly, it even allows a lender to pull a credit report right off the screen for the borrower to review instantaneously. It allows a lender to discuss with the borrower what he or she needs to do in order to qualify for a mortgage.

Now, while the processing and underwriting may be performed by GE, the loan is closed in the name of the institution and owned by that institution. Loans may be held in their portfolio, or they can sell them to GE or secondary market sale or other institutions.

Equally as important, homebuyers are provided access to all of our conventional mortgage products, including the Community Homebuyers Program and other low down payment programs. It is critical that underserved neighborhoods have access to all types of mortgage products, both conventional and Government insured.

For example, City National Bank, a small minority-owned bank in Newark, New Jersey, made only three mortgages in all of 1992. I am pleased to report that since entering the Residential Express Program on March 1, they have registered 25 loans, 8 in the first 3 weeks of June.

I am excited about Residential Express, although the program only began in February, it is growing at a geometric rate. It has averaged a growth rate of 112 percent a month in mortgage activity. Mortgage loans from $15,000 to $20,000 have been made as well as larger mortgages that have been accommodated through the system. Residential Express meets the full spectrum of the community's needs.

We have also entered the rule markets as well. In Glasgow, Montana, and Hulbert, Oklahoma, we are the first to bring national mortgage markets to these rural homebuyers and the Native Americans. At Valley Bank in Glasgow, a town of 4,500 residents and over 3 hours from the nearest metropolitan area, seven loans were registered in the past month totaling over a half million dollars. Without the latest technology, these markets could never be effectively served by the variety of desirable mortgage products and services.

I believe that programs like Residential Express and the community homebuyers that rely on new technology and build on institutions already serving their community are the kinds of partnerships which should be encouraged by Congress and the administration.

We at GE are aware that controversy has developed concerning the rules for operating computerized loan origination systems. I am not a lawyer or a RESPA expert but rather a businessman and mortgage banker. We have not been involved in the forefront of the regulatory debate regarding RESPA and CLO's. This is not to say we are not interested in how these issues are involved. But until now our focus has been on the development and application of new technology.

From our experience, I can tell you that this technology has the potential to bring immense benefits to many homebuyers in all areas across the Nation. This is especially true in underserved urban and rural areas. CLO's can provide homeowners the means

to access national mortgage credit capital markets in ways which are as sophisticated as any available to homebuyers in upper-income neighborhoods.

This is important that this technology not be prematurely circumscribed by any rules which may be designed to protect against abuses more imagined than real. We think that HUD was correct when it stated in the preamble to its RESPA regulations that there are, and I quote, "potentially substantial consumer benefits in the utilization of new technology. Further, the technology was in flux and represented, at most, no more than 1 to 2 percent of mortgage originations annually. Considering all of these factors, HUD concluded it would issue a CLO exemption which would have the effect of eliminating possible regulatory inhibitions on the development of this technology."

In closing, we are now reaching out to underserved markets through Residential Express services available at minority- and community-owned banking financial institution. But in the future we may utilize this technology with nonprofit groups, majority- or minority-owned real estate companies.

Please don't close off these avenues to bring mortgage services to inner city and rural families and, indeed, to all homebuyers.

We believe that the speed, convenience, and cost savings associated with computerized loan origination are too important to be lost in any intramural turf battle among settlement service providers.

Mr. Chairman, our experience has taught us three important lessons.

First, no single entity can provide the entire solution to the problems of these underserved communities. It takes the collective strength of all of us in Government at all levels, nonprofits, community groups and the private sector — working in partnership.

Second, it is essential to link underserved neighborhoods to the mainstream community. We at GE have been the link, providing knowledge, the latest technology, and access to capital.

Finally, in order to be successful, these programs must be good and profitable business. Only commercially viable efforts will sustain the large infusion of private sector dollars, the big dollars, needed over the long term.

If we apply these lessons to residents and businesses in economically underserved communities, I am very confident that we will make good progress in bringing these neighborhoods into the economic mainstream of society.

Mr. Chairman and members of this committee, I really do appreciate the opportunity to testify on these important programs and would be more than pleased to answer any questions.

[Mr. Sims' statement may be found in the appendix.]

Chairman LaFalce. Thank you very, very much.

We have had a very distinguished panel of expert witnesses. One of the difficulties is, you are all too good, because I tended to agree with each of you after I listened to you. The problem was you disagreed with each other.

So I am going to ask you to do me a little bit of a favor and that is to walk me through it, OK?

I am going to ask, in particular Mr. Rowland, Mr. Spera, and Mr. Sims, to walk me through their shop. Then afterwards — and I am

going to try to find out how will you be benefited, how will you be hurt.

Afterwards, I am going to ask Mr. Birmiel, Mr. Bell, and Mr. Tasker to tell me how I could have been disadvantaged and I was unaware of it.

Mr. Rowland, Mr. Spera, and Mr. Sims, I am looking for a house. Let's say I want to spend $200,000 for a house, and I come into your realty company and I say, would you represent me and find me a house; I want three bedrooms, a bathroom on the first floor, et cetera, et cetera, et cetera; and I don't have too much for a down payment; so I want a pretty good sized mortgage, too.

Do we enter into a contract? Do I sign a contract with you, or not? No contract, right?

Mr. ROWLAND. Would you like to have the process described as it might happen in a Long & Foster office, for instance?

Chairman LAFALCE. Sure.

Mr. ROWLAND. Because Long & Foster is a sister company to the mortgage company. As you enter the Long & Foster office, as you meet an agent, that agent would have given you a disclosure on the relationship between Long & Foster and the name of the mortgage company.

Chairman LAFALCE. How big is this statement?

Mr. ROWLAND. Full-sized legal sheet. It is not buried in the small print.

Chairman LAFALCE. How many sheets of paper are you going to be giving me?

Mr. ROWLAND. That will be the initial sheet you get from the Long & Foster agent.

Chairman LAFALCE. Are there any other sheets you will be given?

Mr. ROWLAND. It depends on what kind of real estate services you would like with that agent. You can sign up a buyer broker——

Chairman LAFALCE. You mean when I tell you I want you to help me find a house, the first thing you are going to do is tell me you are not just a real estate agent, but your company is affiliated with somebody else?

Mr. ROWLAND. Absolutely.

Chairman LAFALCE. We are not going to find a house for 3 months, probably, right?

Mr. ROWLAND. That is not necessarily — it would depend on you.

Chairman LAFALCE. With me it is probably going to be 6 months. I am a pretty fussy guy. I don't know that I will read that paper. If I read it, I may well have forgotten about it, because it is 3 months since you gave it to me.

Mr. ROWLAND. Real estate is a complicated business. It is because of laws——

Chairman LAFALCE. All right.

Mr. ROWLAND. It is because of the laws that these disclosures are required.

Chairman LAFALCE. Now it is 5 months later and you have been taking me around. As far as I am concerned, you are my guy. I am your guy. You and I have got a real good relationship. I trust you,

OK? I found this house, I look at it, let's buy it. What do we do next?

Mr. ROWLAND. Typically a real estate agent at that point would again, hopefully a real estate agent would have helped you prepare for the mortgage process not at the last minute, but as you begin to look, he or she would have asked you questions about what kind of a mortgage you are looking for.

Chairman LAFALCE. The company you are associated with also offers mortgages, right?

Mr. ROWLAND. Absolutely. I would like to give you that information as well as that same disclosure that agent will also give you three additional companies that you might——

Chairman LAFALCE. Why three?

Mr. ROWLAND. That is just a standard practice.

Chairman LAFALCE. It doesn't have to be three?

Mr. ROWLAND. That is something I guess I would defer to the NAR on.

Chairman LAFALCE. Does it have to be three? Does it have to be five? Does it have to be one other? Could it be no other?

Mr. TASKER. I don't think there has to be anything.

Chairman LAFALCE. There is no requirement. You could just say, your own company, right? You wouldn't have to tell me that at that time, would you?

Mr. ROWLAND. Yes, you would be — if I were your real estate agent, I would be required, if we had an affiliated mortgage company, to tell you at the first contact that we had those other relationships.

Chairman LAFALCE. You told me that 5 months ago, and now you are telling me that if I want a mortgage fast, I could——

Mr. ROWLAND. We would have started 5 months ago. I would have encouraged you as your agent to seek financial assistance early.

Chairman LAFALCE. Five months ago would you have started me on at least three or maybe just with yours?

Mr. ROWLAND. Or the company would have started you with at least three, and letting the consumer make the choice.

Chairman LAFALCE. But there is no requirement for that at all?

Mr. BILBRAY. Mr. Chairman, when I bought my home here they prequalified me early to find out how much I could qualify for. Is that typical of what you do too?

Mr. ROWLAND. Very typical.

Mr. BILBRAY. But you do that through your own mortgage company or any company that I said at the time?

Mr. ROWLAND. We disclose the relationship to the consumer at the first contact, and make a referral of at least three mortgage lenders, in addition to our own, at the first contact.

Chairman LAFALCE. Let's assume you are a good guy and you are doing the three. There is at least a hundred out there, right?

Mr. ROWLAND. At least 100.

Chairman LAFALCE. And I would imagine on this totem pole of a hundred there have got to be some that are really, really good, and some that are really, really bad.

Mr. ROWLAND. I assume that, too.

Chairman LaFalce. How do I know you are not giving me three that are really, really bad?

Mr. Rowland. Chairman LaFalce, I would have to assume that this is not the same consumer we had in 1975. There is tremendous information available in the marketplace.

Chairman LaFalce. That is right, because there is so much information the consumer is 10 times more confused than he was before. Ten times more confused. Therefore he needs to have trust in you more than he ever had before.

Mr. Rowland. Absolutely.

Chairman LaFalce. The problem is, I can't go into your mind and I know you are a good-looking guy, a presentable guy.

Mr. Rowland. Thank you.

Chairman LaFalce. But I don't know if you are a real good guy. You sound good, you look good, but are you good?

Mr. Rowland. I might make the point——

Chairman LaFalce. Maybe you are too good for me?

Mr. Rowland. That is one of the strongest arguments in favor of controlled businesses, because if I were not a good guy, my being associated with the real estate activity could be damaging to many, many other people in their livelihood. As an independent mortgage person who you come——

Chairman LaFalce. You could be a bad guy to me which could be good to all your associates. I am concerned about whether you are going to be a good guy to me. I want the best deal I can get.

Mr. Rowland. Your real estate agent is not compensated from the mortgage company, and would hope to make much more out of her relationship or his relationship with you——

Chairman LaFalce. There is no financial relationship between you and this mortgage company affiliate of the real estate brokerage of which you are an agent?

Mr. Rowland. As an independent agent that is expressly prohibited.

Chairman LaFalce. Is there any type of financial remuneration that——

Mr. Rowland. No, sir.

Chairman LaFalce. What about a promotion? Might you be promoted? Might you get a bonus?

Mr. Rowland. As a real estate agent? I am an independent contractor who affiliates with the real estate broker as an independent contractor. So as an independent contractor, I see our relationship as one where if I do a good job for you, you will make a recommendation for your colleagues to buy houses through my company and through me. So I have too much at risk to refer you to——

Chairman LaFalce. To tell you the truth, I won't even know whether you have been good or bad to me. As long as the deal closes, I am going to walk away happy not knowing whether I did or didn't get a good deal. Of course, there are so many things to getting a good deal or a bad deal. These points are so confusing to me.

The maturity of the loans are so confusing to me. The additional fees that there may or may not be added on, you negotiating the points, I get all confused about points.

Mr. ROWLAND. Truth in lending legislation requires that all of that be disclosed.

Chairman LAFALCE. But you can disclose as much as you want. I don't understand it. I just really don't understand it.

Mr. BILBRAY. I agree, Mr. Chairman. I am an attorney and I couldn't understand mine when I closed it. I have to have somebody really explain it.

Chairman LAFALCE. But you know what is making it even more complex for me, you have got computers today, and I can't use computers, because when I went to school I couldn't learn how to type much less learn on a computer. But how are you going to use this computer for me? Have you got a computer in your shop? Is this one of these new things, this computer loan origination?

Mr. ROWLAND. Are you asking me as a mortgage banker or as a real estate agent?

Chairman LAFALCE. You are my friend. You are the guy — I come into the community and, I went to you. So you are everything to me. I don't pigeonhole you. You are my future for the next 30 or 40 years.

Mr. ROWLAND. I am a real estate agent?

Mr. BILBRAY. You are my agent.

Mr. ROWLAND. Through many of the multiple listing services in this area, real estate agents have access to computerized programs for prequalifying to show the benefits of renting or buying.

Chairman LAFALCE. Are you going to use one of these for me?

Mr. ROWLAND. As a real estate agent I may do that, and that won't be associated with any particular lender whatsoever. That is simply a real estate agent knowing about mortgages giving you counseling before you even get to the lender.

Chairman LAFALCE. Who buys all this equipment? Your real estate company does?

Mr. ROWLAND. The real estate company would have the multiple listing service terminals in their offices.

Chairman LAFALCE. This multiple listing, is this the same thing as computer loan origination?

Mr. ROWLAND. Absolutely not.

Chairman LAFALCE. Oh, it is not?

Mr. ROWLAND. Absolutely not.

Chairman LAFALCE. What about this computer loan origination?

Mr. ROWLAND. There are computerized loan origination systems——

Chairman LAFALCE. Does your office use one of those?

Mr. ROWLAND. No, we do not.

Chairman LAFALCE. Mr. Spera, do you have one of these computer loan origination——

Mr. SPERA. At this particular time my office does not. We are waiting for the technology to offer that to us. We certainly would like to be a recipient of that opportunity and offer that service.

Chairman LAFALCE. I want to find out about this — there is no GE real estate mortgage division in my neighborhood, so I am not going to walk into some store that says GE capital mortgage services, right?

Mr. SIMS. No, you are not, because we are——

Chairman LAFALCE. Who am I going to walk into that is going to hook me into dealing with you, Mr. Sims?

Mr. SIMS. A bank, thrift or credit union.

Chairman LAFALCE. The reason I am going to this bank is because the branch manager goes to the same church I go to on Sunday, all right?

Mr. SIMS. That is a good start.

Chairman LAFALCE. But that is all I know. I don't know whether it is a good banker. I really don't know — all I know is, hey, he goes to the same church I do, he sees me there, he is probably going to be nice to me.

How do you come into this picture? You don't go to my church.

Mrs. MEYERS. Mr. Chairman, all I know is, after this hearing nobody is going to want to sell you a house.

Chairman LAFALCE. I want you to know I am not as dumb as I appear.

Mrs. MEYERS. I will second that.

Mr. SIMS. In our case under the residential express network, you would be actually going into your local community bank, thrift or credit union, and we will already have been there if they have our network and have trained the personnel they have selected on-site to actually take applications and understand programs or products.

Chairman LAFALCE. But this is a bank, this is a thrift. They have been in the business of taking applications for mortgages for a long time. I mean, I can't think of — I can't think of any S&L, or any savings bank, or any commercial bank where I live that hasn't been giving residential mortgages for a long time. Who are you training?

Mr. SIMS. I would be inclined to agree on the S&L for the most part, but certainly in credit unions and commercial banks, and our experience has been the programs that they are offering are not always the ones that consumers are looking for. In fact, since they haven't been able to be connected into perhaps Fannie Mae, Freddie Mac or the secondary market, but they are offering the consumer not what the consumer is looking for, so we are indeed training them and helping them set up their mortgage departments.

Chairman LAFALCE. So you're really dealing with very, very small neighborhoods?

Mr. SIMS. The bulk of the institutions are small, that is correct.

Chairman LAFALCE. But these are small neighborhoods — excuse me, small little institutions. Isn't the portfolio of most small institutions, save credit units, residential mortgages?

Mr. SIMS. No. The problem is, and I can go through it very quickly, we are in a 7 percent, roughly, fixed rate environment, and if they were to put your loan on the books for 30 years at 7 percent, and then if we get into an environment where they have to pay you 11 or 12 percent, like your CD, they have a problem, and since they are not connected to the secondary market, we have enabled them to sell those loans through our network so they can do many, many loans in the community.

Chairman LAFALCE. The facilitators of secondary markets is something I have a little knowledge of and understand. But what has that got to do with loan origination?

Mr. SIMS. Because they take your operation and work in tandem with us to underwrite and process the loan, that is done electronically with a PC at the bank.

Chairman LAFALCE. So you have gone into this bank that didn't know how to make mortgages and you have trained this bank that should have known how to make mortgages how to make mortgages. But you didn't do this for nothing, did you?

Mr. SIMS. No, we did not.

Chairman LAFALCE. What type of fee did you get from the bank?

Mr. SIMS. We charged the bank probably no more than $1,500 to do the training and set them up.

Chairman LAFALCE. By set them up, how do you set them up? You provide your computers to them?

Mr. SIMS. No, we do not.

Chairman LAFALCE. They use their own computers?

Mr. SIMS. Yes, we do. We do give them software for their computer.

Chairman LAFALCE. You give it or sell it to them?

Mr. SIMS. Give it to them. We give it to them in the confines of the $1,500. We are there for 3 days. I mean, when we went to Hulbert, Oklahoma, for example, it is a long ways. The $1,500 went to help defray some of those costs to train some local bank personnel. The other thing is it is not so much they didn't know how to do the mortgages——

Chairman LAFALCE. Now they have access to this computer, how is this going to help me? What is on the computer? What is the information that is on there? Is it all about GE's——

Mr. SIMS. It is a full array of programs including bank portfolio products and GE products if they chose to sell us a loan.

Chairman LAFALCE. Well, now, what consumer products are out there? We could pretty much guarantee the GE products will be on there, correct?

Mr. SIMS. If they are part of our network, yes, sure.

Chairman LAFALCE. What other products of competitors of GE would be on there?

Mr. SIMS. That would be up to the bank, If they wanted to go that route. I would say currently since we are just getting these small community banks into business, it is their programs and pricing and ours only.

Chairman LAFALCE. So in other words, this computer loan origination could just have the bank that previously wasn't giving mortgages and your own product, there may be no other; correct?

Mr. SIMS. Yes, but at the same time when they close the loan, it is in their name and they own it. They are under no obligation to sell GE that loan.

Chairman LAFALCE. I understand that.

Mr. SIMS. So they could sell it now on the secondary market because we have given them the tools to take applications in a way that the market accepts it.

Chairman LAFALCE. I understand. I understand. But where is the benefit to me, though? That is a hookup with you, but that is not giving me a choice. Wouldn't I be better off if somebody would give me a wide array of choices?

Mr. ROWLAND. That in fact was one choice you didn't have living in that small community before. I think that is an example of the excellent use of technology, even though it brings one group of products, those are additional products, additional choices for you as a consumer.

Chairman LAFALCE. I don't think there is any question that we have to recognize that technology can give the consumers additional advantages today. The question is, what type of qualifications should we put on it.

We have a number of issues. One of them is computerized loan origination, but one of them is controlled businesses, too. With respect to the computer loan originations, there is a big difference between the regulations that were promulgated November 2, 1992, and the regulations that were going to be promulgated 4 years earlier by HUD, night and day difference. It is almost impossible to defend the regulation promulgated in 1992 knowing what was going to be promulgated 4 years earlier.

Would you agree with that, Mr. Rowland?

Mr. ROWLAND. I would not.

Chairman LAFALCE. Mr. Tasker, would you agree with that?

Mr. BILBRAY. Is there anybody who agrees with it?

Chairman LAFALCE. Oh, yes. There are at least three and probably more, but not publicly.

Mr. ROWLAND. I think whenever you impose those restrictions, you limit the use of the technology.

Chairman LAFALCE. What were the restrictions in the rule we thought was going to be promulgated 4 years ago?

Mr. ROWLAND. As I remember, there would be a restriction of the amount that could be earned.

Mr. TASKER. It limited the fee which the real estate broker could be paid for assisting in the credit process, and even that limit was probably too high at the time.

Mr. ROWLAND. Is that really something that we need to legislate? Would not the market take care of that?

Mr. TASKER. It hasn't in the past.

Chairman LAFALCE. What about requiring that multiple products be offered? I mean, multiple lenders. All the lenders who want to take advantage of that be able to.

Mr. TASKER. That was a good process, because it exposed the consumer to a more competitive array of products in order to obtain their loan.

Chairman LAFALCE. Right now you could just have one, or you could have one plus three bad ones, but it is not required to have all those lenders who want to be part of your system.

Mr. TASKER. I think it is an interesting process when we historically go back and review Citicorp's mortgage power. Citicorp set up a process whereby the real estate broker could be paid a half a percent or at much as a 1 percent fee for referring the loan into Citicorp.

At the time, I was running Weyerhaeuser Mortgage Co.'s operations across the country and we had an office in Long Island right near a mortgage power office, and my manager brought me in the price sheets and compared the price of a loan through Citicorp versus a loan through Weyerhaeuser. We were more competitive

both in fee and interest rate. Yet the borrowers were steered into the Citicorp mortgage power office because the realtor was paid a kickback.

Chairman LAFALCE. Whatever happened to that program at Citicorp?

Mr. TASKER. Citicorp developed the highest delinquencies of any lender in the country and shut it down.

Chairman LAFALCE. They were just too aggressive?

Mr. TASKER. It was evidence that if you have the realtor involved in the credit process, the credit process will deteriorate.

Mr. ROWLAND. I think a distinction needs to be made that this is the individual agent involved as compared to an owner of a real estate company also being involved in a mortgage operation. That is an important distinction.

Mr. TASKER. My background is 21 years in a real estate company that started a mortgage operation. I can recall from years and years and years, whether the manager was compensated because the company was in the mortgage business or whether the agent was compensated, it still affected the credit process so that the credit deteriorated on the overall mortgage application.

Chairman LAFALCE. If I go to this bank, are they going to charge me a fee for using this computer?

Mr. SIMS. No.

Chairman LAFALCE. They are not?

Mr. SIMS. No.

Chairman LAFALCE. How are they going to eat the cost of this computer? They just eat it somehow?

Mr. SIMS. It would be similar to other loans, car loans, consumer loans, whatever. I don't think they single out the $10 or $20 charge on the process. If there are charges, I am unaware.

Chairman LAFALCE. What about realtors that use computer loan origination? For the most part do they charge fees?

Mr. SPERA. They can charge fees.

Chairman LAFALCE. OK, but for the most part do they?

Mr. SPERA. Those realtors that are practicing that do charge fees, yes.

Chairman LAFALCE. Is it disclosed up front ahead of time that they are charging a fee for this?

Mr. SPERA. Yes, sir, that is correct.

Chairman LAFALCE. Is there any type of remuneration going to the real estate agents? Of course, the real estate agent doesn't have the computer. It is the real estate broker that has the computer.

Mr. SPERA. That is correct. That is the sequence, Mr. Chairman.

I may just for a moment go back to your illustration about your pursuit of the American dream, and you found this house. Let me speak at a very basic level about what a realtor would do in a brokerage scenario. The disclosure that Mr. Rowland mentioned is clearly important because initially the first point of contact discloses who that agent would be working for, both in the procurement of a property — traditionally, let's say, if they are working for the seller, there is disclosure that the properties shown will be clients.

Chairman LAFALCE. I have always had a problem with that, because here I thought Mr. Rowland was my guy. Then I find out this

$200,000 house was listed through him by a friend of his that he goes to church with. The fact of the matter is, I thought he was my guy, but he is really the seller's guy. Is that right?

Mr. ROWLAND. That is not necessarily true. That is a whole other area of law, the disclosure of agency, whether you are a agent for the seller, dual agent, agent for the buyer.

Chairman LAFALCE. I want to do a little reading on that and I will come back to that issue in about 15 minutes. During that time, I will call on some other Members. Mrs. Meyers, and then Mr. Bilbray.

Mrs. MEYERS. Thank you, Mr. Chairman.

Mr. Bell, can you describe for the committee maybe specifically what kinds of problems arose in Kansas that led to the State insurance commissioner's concern?

Mr. BELL. Yes. In the Kansas City, Kansas area, there had been a number of controlled business situations for a long time. The insurance commissioner received complaints, and as RESPA police have found out, most of the complaints come from competitors, because they are the ones that find out about these arrangements.

There were five specific arrangements that the commissioner looked at. One was the shell company arrangement I mentioned earlier, where they didn't do any work at all and had no employees, but enjoyed the difference between the contract price — they farmed out the work to a controlled title company for a reduced fee — and the parties to the transaction were being charged the going rate.

There was another arrangement where realtors were put on the board of directors of the existing title company and were compensated in direct proportion as they contributed and referred their business to that title company. So it wasn't $100 a month for everybody. It was $500 for you if you contributed that much, and maybe five bucks for the guy that wasn't doing anything.

Third, there was an arrangement, another company that was approaching realtors to hire their closing help, we will pay your closing secretary, she will be our employee, we will pay your rent for the amount of square footage her desk occupies, and therefore we will provide you with in effect free closings supported by your former employee that knows how you like to do them.

There was another company that leased space from a large broker in the Kansas City area office space, at what the commissioner termed greater than market value. Most of the space was never occupied. It sat vacant during the term of the lease, but surprise, surprise, the title company got that broker's business.

Last, there were two enterprising young men that formed a shell title company in the area, and put the proposal in writing, which was a little unusual for these arrangements, and had a joint meeting with real estate brokers. The invitations went to brokers they had a meeting of the brokers at which they announced they had formed this title company and they were going to market shares of ownership to brokers; that they were selling the shares for a dollar a piece, and they guaranteed these brokers at the end of the first year their income would be between $7,800 and $8,500 a share. This income was derived from the profits of the shell which charged the going published rates for title insurance, while they

bought their title commitments and policies at reduced rates in return for the guaranty of business to that provider of title commitment.

These were the five that were studied by the commissioner. This was in August of 1987. These particular companies all signed letters of consent. They denied their doing anything wrong, but they agreed to quit doing it. That was the initial step toward controlled business regulation. The commissioner felt that he had solved the problem.

Then in January 1988, a lawsuit was filed by a home buyer against a controlled business realtor who also had a building company, who also had a mortgage company. That hit the newspapers. The commissioner decided he hadn't solved the problem. That is why he appointed the committee I mentioned in my oral remarks, with representatives from the mortgage bankers, commercial banks, realtors, the controlled business owner, the Kansas Line Title Association had a representative, and the insurance department. Have I left out anybody? I don't think so.

This committee met, broke into subcommittees. I was not on that committee. But they made a recommendation to the commissioner what turned out to be House Bill 2502 that incorporated basically the regulatory provisions regarding controlled business that was in the National Association of Insurance Commissioners model title act. That is where the —20 percent provision came from. As I mentioned, that passed the Kansas legislature after considerable discussion, particularly on the Senate Floor, 61 to 2.

Guardian Title, who had controlled business arrangements in the Kansas City area, and Wichita Title Associates, which was a controlled business entity that started in Wichita that was composed of the three largest real estate operations in the county plus three other very active real estate companies and two leading lenders who had control of at least 60 percent of the total title business in our county, they joined in this lawsuit claiming the legislation was unconstitutional.

The district court agreed with them. The insurance department appealed to the Supreme Court. Remember, it was their legislation.

The court in January of 1991 came out with a unanimous decision saying the commissioner was charged with controlling and regulating insurance in the State of Kansas and if he felt the integration of real estate market was anticompetitive, they had every right in the world to regulate it, and that was a unanimous decision.

Mrs. MEYERS. Thank you very much, Mr. Bell.

I would like to ask one more question and then as I understand it, Mr. Bilbray has to leave and would like to question, so I will defer to him. But one more, and maybe some of the rest of you could comment on this, too.

Obviously the recommendation that you can only obtain 20 percent of your gross revenue from a controlled business is obviously a compromise position. It allows these associations to take place, but it controls the percentage of business. It is recommended by the National Association of Insurance Commissioners, it has been adopted by Kansas, and I believe some other States, I think — I am not sure whether Minnesota adopted it or not. But I would like to

have Mr. Bell and then maybe Mr. Spera comment on, we have two very opposing viewpoints here.

Is this a logical way to respond to this, or is this a response that makes nobody happy and is not beneficial to the consumer? Mr. Bell, you start, and then I would like to hear from Mr. Spera.

Mr. BELL. I think the obvious thing is, we want to maintain competition in the title industry. That solves all the other attendant problems. You can say that companies ought to adhere to certain rates. They can say they don't charge over that but they can hide it in other fees, closing fees, for instance. You can charge for document preparation. One company can, and another company includes it in their published fee. You can charge for notary services.

There are all kinds of ways to go around pricing and filed rates, and it appears you are charging the same rate as the guy down the street when actually you are padding the bill. To try to regulate those kind of arrangements we think is just impossible. We are all very inventive and we will find a way around it.

The real way to do it, and the way business should be conducted, in our opinion, in this country, is competition. Let it rain. What is wrong with controlled business arrangements, particularly in the title business, where you buy the house, the realtor walks away, there is maybe some liabilities that hold over him, but — if the basement leaks, that kind of thing. The appraiser walks away, the surveyor walks away, the pest control guy walks away. The title company is there forever.

As long as those people own the title of that company, that policy we issued them is good, and you want to be sure that the title — that is what you are buying when you pay your money. That is what the lender is securing the mortgage with.

Chairman LAFALCE. As long as you don't have too many exceptions in that contract, Mr. Bell. One of my problems is whatever I want to get insured you won't accept. We will talk about that later.

Mr. BELL. I certainly agree with that. The policy gives it to you and the schedule B takes it away. But we feel the only way — what you need to do — come on into the title business. That is fine.

I have been in this business since I was 10 years old and I started delivering abstracts for my father. We have competed with every type of individual, organization you can think of. That doesn't frighten me a bit. Come in, jump in, the water is fine. But what I want to be sure of is those people are competing on the same basis as I am competing.

We had good friends and customers form this title group, this controlled business thing. From that day forward, we couldn't go in their office. We had gone to sales meetings, made presentations over the years, we had gotten business. From that day on, we were frozen out.

Mrs. MEYERS. Does the 20 percent solution work fairly well, or not at all?

Mr. BELL. How the national association of commissioners, insurance commissioners arrived at 20 percent, I don't know. I think that is negotiable. I think it could be 70–30. The purpose is to force everybody into the marketplace. That automatically makes sure you are pricing your products the same because you have got to compete for that business. It means your service is going to com-

pete with everybody else's, the quality of your policies and how many exceptions you are taking to coverage. All of that and still trying to follow the regulations and statutes, competition takes care of it.

What you have got to ensure, particularly to ensure you are getting the right kind of coverage, if it is a company that is going to be there 20 years later when you need them, you have to be sure they are competing and that they are able to stand up in the marketplace.

Mrs. MEYERS. Mr. Spera?

Mr. SPERA. Thank you, Mrs. Meyers.

A specific response to your question, no, the 20 percent threshold is not a solution. Let me say parenthetically that the brokerage business, the fees derived from the traditional brokerage services, the showing of the house to the chairman and the sale of that house, will be the primary source of income and revenue for those real estate offices. We are talking about an expanded scope of diversified services that will better serve the public. Keeping in mind that value received is clearly the true test of the worth and the merit of this request of this proposal and this opportunity that HUD has created, the consumer, the customer, the marketplace, the dynamics of that marketplace are clearly what is going to at the end of the day decide the value and the longevity of this service.

Set fees, no. Fees are not set. They are discussed and agreed upon. The customer service base is clearly what the real estate brokerage business is looking for. It is value received. We have responsibilities to our clients and we have fairness to our customers.

Mrs. MEYERS. You think allowing 20 percent of gross revenues come from controlled businesses would simply not allow those controlled business arrangements to function properly?

Mr. SPERA. Well, I think to set a specific finite percentage does not allow the orderly flow of a business to take place. You may in fact find some office that is very proficient and offers a variety of lenders on their CLO screen and to limit to 20 percent, is in appropriate, your committee deals with small businesses, and the essence of entrepreneurial skills in America is to go out there and meet the challenge in a way that is legal, that creates a service for the public.

So to mandate a set fee, a set percentage is inappropriate, I feel.

Mr. TASKER. One of the thoughts that occurs to me, I know the companies represented here on both sides of the issue are very ethical and have good programs that have been put together by thoughtful legal process. The Mortgage Bankers Association represents 2,600 companies across the country. Over 55 percent of them are small businesses, businesses that cannot compete with GE, with 17 lobbyists, PR firms, and some of the things they can put forth in terms of a capital base.

So my concern is that we maintain the competitiveness of the overall arena. In terms of how loan officers work, how the process works, we fight hard at the MBA to provide education for our membership. We have schools that put our loan officers in the forefront of technology and how to process loans. But it is a constant battle to keep them updated and to keep them focused. Whereas a

realtor who is focused on selling the house and is going to do the loan application process on a part-time or minimal basis can't hope to maintain the integrity of the credit process. That is what concerns me.

Mr. ROWLAND. Mrs. Meyers, I am not a title person, and maybe it is not——

Chairman LAFALCE. I wonder, Mr. Rowland, if we could just put you on hold for a second. I know Mr. Bilbray has some time constraints. I want to enable him — we will come back.

Mr. ROWLAND. It really sort of addresses the question. I am not a title person and I think we all agree that competition is fine and one of the benefits of competition is really bringing new entrants into — allowing new people into the business and ultimately driving down the cost to the consumer.

In that same article that talked about cost savings, it actually addressed the 1990 Kansas law and said that base closing fees filed in Wichita counties by independent title companies jumped from $125 to $200 after the law was enacted. I am not sure we saw the consumer being served there. It may be something I just don't understand.

Mr. BELL. In the first place, it is wrong. The quotation says, diversified providers charged — I am sorry, I am on the wrong line — that all the diversified title providers in the State of Kansas closed down, and then that base closing fees filed of independent title companies with the Kansas insurance commissioner jumped 60 percent, which sounds like every title company in the State of Kansas raised their prices.

Let me tell you, we raised our prices. I think our company has every right, when costs get to the place that we cannot support the service, to either quit the service or raise the price.

Our closing fees did go up 60 percent. We were closing sales transactions and new loans for lenders for $125, most of them were saying, how in the world can you do it, that is too cheap. We knew it was too cheap because we know what our closing service costs us. We did this. The inference is the minute we got rid of the controlled business situation, we had a monopoly and we increased our prices.

The controlled business company that I mentioned in Wichita, I think, understood you couldn't make any money on closings, because they did not perform closing services. They passed that off to the title company that had organized them to start with. So there was no competition between the controlled business company and us on closing fees because they did not participate in it.

We raised our fees a year later after the Supreme Court decision. We felt we were justified to do it. We lost some market share, but at least now we are making some money in closing transactions, and I think we have every right to do that.

Applying that increase to last year's closing volume, it amounted to a 7.8 percent increase in our closing fees. We had not increased them for 5 years. That is less than 2 percent a year. The consumer price index went up 24 percent in that length of time. I think it was entirely justified. It had nothing to do with controlled business.

Chairman LAFALCE. Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

I am sorry I have to be very brief on a couple of questions because I have an 11:30 appointment. I am just a little late.

One of the questions I had in trying to read through some of this is, I noticed on August 7, 1992, HUD in a letter to the acting administrator mentions the fact that the Department of Justice Office of Legal Counsel has been asked to confirm the views which it had related to compensation for affiliated companies. Nowhere in the documents I can find is there any reference to what the Department of Justice came up with and what their conclusion was.

Does anybody know how the Department of Justice has ruled on the fact on compensation and this whole problem we are talking about today?

Mr. BIRMIEL. I can tell you that in our lawsuit we have been trying to obtain the response to the letter and have not been able to obtain it yet.

Mr. BILBRAY. Has anybody gotten a response to this yet?

Mr. SPERA. I believe there was no specific figure for remuneration coming from the Department of Justice. They were on a due — diligence period that they were talking about capping fees, if that is the nature of the question.

Mr. BILBRAY. Yes.

Mr. SPERA. That issue was not decided for capping of any fees, but it was expressed that they would be fair and reasonable.

Mr. BILBRAY. So in other words, nothing came down from the Department of Justice, just by not answering — did they answer?

Mr. SPERA. I do not believe we answered. We do have a RESPA expert in the room from the National Association of Realtors, Ms. Sally Sciacca. She can respond to that.

Mr. BILBRAY. If she can just nod her head. Did we get an answer or not?

Ms. SCIACCA. As I understand it, at the Department of Justice, there was a telephone call, probably someone from HUD answered that. I think they were asked to rule whether HUD had the authority to limit payments between employers and employees. I think that is what the issue was about, rather than caps or anything else.

Mr. BILBRAY. Maybe down the line we can get an answer from somebody that will answer that question, whether or not — what does Justice determine, what they can really do and what they can't. From what I understand in the letter, they were asking the Department of Justice for an opinion on what was the correct view. So hopefully we can get that testimony.

The other thing I noticed in Mr. Holstad's statement, which we only have one copy up here, that Minnesota, they have capped a percentage? Maybe somebody can answer?

I think Mr. Birmiel, you submitted his testimony for the record. Does Minnesota have a percentage right now?

Mr. BIRMIEL. I believe that is what is in controversy, and what the legislature is considering out there.

Mr. BILBRAY. Is it my understanding the big dispute here is, one, I would think, is the problem of full disclosure to the client of the available services, or — versus not being able to do anything inhouse as to mortgages and to closings and so forth. Is that the question?

In other words, if we had a provision or if HUD had a provision that says, We must publish and give to the client not only three people, but say, like, it comes out in The Washington Post every week, a whole list of all the mortgage companies and what they are paying in points, I presume that sheet that comes out in the Saturday edition says, this bank will make a loan 8 percent up to so much for 2 points and so on.

If a client was given, and I think the Chairman pointed this out, not only at the beginning but toward the end when he really has to make his move and select his company and select the attorney, in my State of Nevada you don't select an attorney, you select a title company. But in Virginia where I bought my home I found out you don't have title companies so you deal with attorneys, that what you could do is if we had a provision that said here, you have to give your client a list, and here is a list of 30, 40, or 50 attorneys that do the closing fees, I don't know if you want to put average costs that each one has, something like that, and on top of that mortgage companies with the amount of interest and points they charge, which would not limit the real estate company from having a percentage of the business. They could have 100 percent if they were more competitive and they had a better deal and they could do it more expeditiously at less cost, I am sure the client would pick them.

Would somewhere in between, would this handle the problem?

Mr. Birmiel?

Mr. BIRMIEL. The more disclosures you give the client, the more he is going to turn to his agent in the face of all the information and say, What is good for me, who should I use?

Mr. TASKER. The process is particularly true in first-time buyers, low-income buyers. They don't have the expertise; they have not been exposed to it. So it is much more possible for the real estate broker to steer this person. That is the concern, that they be exposed to the entire marketplace.

So giving him another disclosure, they have a stack of disclosures, and there is no way, as the Chairman said, to absorb all the language and read it all and understand it. It is trying to keep the market open, keep an open playing field for everybody that is important to getting the best interest rate and the best fees.

Mr. BILBRAY. What percentage of mortgage companies are doing this all in-house? There are hundreds of real estate agencies out there, or brokers. Do only the great big ones, the Long & Fosters and, the Coldwell Bankers, are they the only ones doing it, or are 90 percent of the real estate people out there doing it the old fashioned way?

Mr. TASKER. First of all, there are no statistics that can tell you for sure. It is obviously more prevalent in the larger firms.

But I think another issue that concerns us is that I can take a fax machine and stick it in a legal State office and call that a CLO, and if a salesman avails themselves of the CLO with the buyer sitting there, I can pay him a fee. That doesn't justify.

See, one of the problems with the HUD ruling is there is no clear definition on these issues. It doesn't spell it out. So that leaves all this gray area that we need to get resolved.

Chairman LaFalce. Four years ago they did have a definition of a CLO.

Mr. Tasker. That is right. They started one. That was all thrown out the door, for some strange reason that we have been unable to figure out, what influence was brought to bear where that changed that, November 2.

Mr. Bilbray. Does each individual State's real estate division enforce this law, or does — who enforces it? Who goes in and actually — unless somebody tells on you, who actually checks it out, monitors this?

Mr. Tasker. For the most part it is HUD.

Mr. Birmiel. HUD has a small enforcement staff. I believe they would be somewhat overwhelmed by the actual numbers. The numbers actually doing this throughout the country vary from region to region. From southern California, Orange County, if you looked at a letter from the a lady by the name of Debbie Faber, who is closing her escrow company after 15 years because there are only two realty companies in her area that do not have tie-ins with closing operations, she cannot get past the front desk of companies in our area. Those two are now going under the new regulations. They are taking a percentage interest in title companies, and she just had no referral business. She closed on March 31.

This is the systemic problem that can arise now that the cat is out of the bag and everyone in the country knows how they can set up a title operation. All they have to do is refer the business. They don't have to take the responsibility. They can own a piece of the title company. The larger companies in some area, where they control large parts of the market and have these entities, they really control large parts of the——

Chairman LaFalce. This is a totally separate issue from the computer loan origination.

Mr. Birmiel. Exactly. Controlled business issue.

Mr. Bell. Mr. Bilbray, speaking to disclosure, we had this controlled business operation in Wichita. They were supposed to disclose, and I am sure some of them did, but a lot of them didn't. In fact, we had a friend of my brother's who demanded — now, most people don't know title companies, don't know they are involved, have no idea what they do and think we charge too much money. If they do know us at all, I would hazard a guess the members of the committee do not know who insured the title to their property.

It is typical that the real estate salesperson is the one who has, we think, a fiduciary responsibility to act on those matters for their clients, and they are supposed to make the best choice based on price, service, quality of the service that they have determined in the community by virtue of being in the business.

We think when you introduce financial gain for anyone involved in that equation, that is then corrupted. This friend of my brother——

Mr. Bilbray. Mr. Bell, didn't Mr. Spera say they don't compensate, or somebody did, or Long & Foster, Mr. Rowland, they do not compensate their employees for this referral?

Mr. Rowland. Independent agents. A real estate agent under the RESPA regulation is prohibited from receiving compensation. They have to be an employee.

Mr. BELL. I don't think that is quite right. I think they can compensate their employees, and then the distinction is made between an independent contractor — Mr. Birmiel mentioned, there are a myriad of ways, other than handing some money. There are desk charges, what they pay for advertising, the referrals they get for the company listings.

Chairman LAFALCE. A week's vacation to Hawaii.

Mr. BELL. Don't kid yourself. One way or the other the pressure will be applied. But we had salespeople who were loyal to us, that one-on-one sat down with their sales managers who said, Aren't you going to be loyal to this company? The owners of this company now have a title company, why aren't you doing business with us? It got very personal.

Going back to this friend of my brother who asked for us, it was in the contract, we were supposed to do the title work, and the controlled business company got it. They didn't pay any attention to it.

Disclosure is great and it sounds wonderful, but to us you have got to put the burden back some way on trying to make the agent make the right decision for his clients. If you keep the title company in competition with everybody else, then I think you have solved the problem very easily.

Mr. BILBRAY. Thank you.

Chairman LAFALCE. Going back to my agent again, you work for a broker.

Mr. ROWLAND. Yes.

Chairman LAFALCE. Your broker owns a mortgage origination company, right?

Mr. ROWLAND. Right.

Chairman LAFALCE. What percent of the sales——

Mr. ROWLAND. Market share?

Chairman LAFALCE. No. Of all those people you found homes for in the year 1992, what percentage of them got their mortgage from your company as opposed to someone else?

Mr. ROWLAND. I am so glad you finally asked that question. We do track that statistic. We want to know how effective — I mean, I run the mortgage company. I am a mortgage guy. Of course my answer would be, I would like to get it all. But we have to earn it all.

I think this is a point that everyone at the table needs to understand, that this the independent contractor, the real estate agent, is very independent, and they don't care about desk fees if it costs them a customer. So the point is, our company, we do a lot of business, and we do 6 percent of Long & Foster's business, 6 percent. So I would find it hard to find an example of where I might have disadvantaged a competitor who provided better service or better costs.

Chairman LAFALCE. Do we have any industry data where we have a brokerage and a brokerage-owned mortgage company, to find out what percentage of most brokers' agents' purchases are being referred to that mortgage origination company?

Mr. ROWLAND. I am not aware of any.

Mr. TASKER. The Mortgage Bankers Association, Mr. Chairman, doesn't have that information. We haven't even delineated exactly which companies are affiliated and which are not. My concern is

that there are many small companies that have not competed on a retail basis, that are seeing this change in the regulations as a way to circumvent competition and competing on an open field.

Chairman LaFalce. One thing I am concerned about, we always have a tendency to look to money. If there is a change of hands of money, that is easily traceable.

What about something other than money, something of value? Don't real estate brokers, automobile dealers, insurance companies, you name it, have contests? Don't they say, If you sell X number of a certain type of cars this month, you can qualify for a trip to San Francisco or Hawaii or something like that? Does this same type of activity go on within real estate companies, in banks, et cetera? I am not just referring to a free trip; I am just talking about something of value other than money.

Mr. Tasker. If I was the manager of a real estate office and I was compensated by my affiliate lender for each transaction I ran through that affiliate lender, don't you think I would put some pressure on my salespeople? Don't you think I could influence their behavior to some effect? I mean, it would be important to me because I would be directly compensated if I put 10 transactions through the mortgage company or if I put 100 transactions.

It also affects my career, my ability to progress up within that company. You bet there are other methods.

Chairman LaFalce. Mr. Birmiel?

Mr. Birmiel. If I may refer to HUD's own regulatory impact analysis in which they said up to 55 percent of the transactions will involve controlled businesses, this is from HUD. In the same breath they said it would have no effect upon small entities, no significant impact on small entities.

Mr. Tasker. If you go back and talk to the staff at HUD today, the staff that has been there through many different administrations, you will find that they are very aware of this problem, and that maybe they didn't even agree with the changes that were put into effect November 2.

Chairman LaFalce. Sounds as if you are suggesting some political skulduggery, Mr. Tasker.

Mr. Tasker. Not necessarily. I don't want to be quoted saying that.

Mr. Sims. I call on these presidents of small businesses every week all over the country now, and have been since the beginning of the year, and the presidents of small banks, which is also a small business, and I am a little confused, I guess, because I know that the latest and the best technology is what we are using to connect them for the first time to either retain their customer or give their customer a better choice.

I just hope we don't mess with that. Because we are having great success in areas that when I go through the door to the bank to sit down with that president, he or she or their board, they tell me I am the first person from a major corporation that has ever been there, that has ever taken a look at connecting them in.

I am not talking about use technology or some of our old stuff. It is the best stuff that we have ever developed, is what we are bringing to the table. It is working.

Chairman LaFalce. The difficulty is, this is a difficult issue. If it were not a difficult issue it wouldn't have been around so long. There are competing truths working against each other. There are competing interests working against each other, all of which have validity.

I think the trick is going to be for HUD or for the Congress to find the appropriate accommodation of these valid but competing interests. I agree with you, we have got to take advantage of the latest technology, especially in niche areas, underserved areas, where maybe the competition and profits have just not been to the advantage of the consumer.

By the same tone, the present rules, especially with respect to-well, with respect to both, but especially controlled business arrangements, are ripe for abuse, in my judgment. I am not saying that we should permit certain type of activities, but it seems to me they must be much more qualified.

I have come to no firm conclusion to this at all, because it is very complex, and I have just begun to scratch the surface of this issue. HUD wrestled with it for years and years and it still wrestling with it as evidenced by the fact that they will be noticing a hearing very, very shortly.

But I have got to get to the floor now. We are about to take up that amendment. I have to bring today's hearing to a close.

I want to thank you. This has been an extremely interesting, extremely important, and extremely informative hearing, and I hope it will help HUD, in their future deliberations, and who knows, Congress, should it be necessary for Congress to have any future deliberations on this issue.

Thank you very much.

[Whereupon, at 11:55 a.m., the committee was adjourned, subject to the call of the Chair.]

# APPENDIX

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HEARING ON THE IMPACT OF IMPLEMENTATION OF THE REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA) ON SMALL BUSINESS

OPENING STATEMENT BY
CHAIRMAN JOHN J. LaFALCE

The Committee will please come to order.

This morning's hearing concerns regulations issued by the Department of Housing and Urban Development just prior to the November 1992 election affecting various aspects of the real estate industry under RESPA (the Real Estate Settlement Procedures Act). The regulations permitted certain activities including the pooling of computerized information about mortgage availability and, in some circumstances, remuneration for referrals to providers of settlement services.

RESPA was first enacted by Congress in 1974 to protect consumers from unnecessarily high real estate settlement charges due to abusive practices. Among other things, RESPA prohibited kickbacks or other fees relating simply to the referral of business to providers of settlement services. Congress addressed RESPA again in 1983, adopting certain amendments seeking to clarify the statute and how it should be interpreted.

Over the years HUD has issued various informal opinions on aspects of RESPA. In addition, HUD published proposed

regulations in May of 1988. By December of that year, HUD had developed proposals for a final rule on referral fees under RESPA. But the final rule was not promulgated, and then last November, literally days before the 1992 election, HUD published regulations concerning controlled business arrangements and computerized loan origination systems, to become effective in thirty days.

It is curious that it took literally years for HUD to address these issues and then promulgated them only days before a national election. Some have alleged that HUD was put under considerable pressure to issue those regulations by then Vice President Quayle's competitiveness council. I personally take no position on that, one way or the other.

Proponents of the new regulations believe that they promote efficiency and enable consumers to gain access to better, faster service. They say that the regulations merely reflect the changing nature of the real estate marketplace.

Opponents, on the other hand, say that the regulations unfairly discriminate against small businesses which are independent providers of settlement services. They maintain that competition will be weakened and consumers will suffer if the regulations are permitted to remain in effect.

There is some interesting news regarding this issue which I would like to report at this time. Late yesterday we were advised by HUD that very shortly they will be publishing a notice for a public hearing to address a number of issues concerning the regulations that were issued in November. This notice is on file at the Federal Register and should be published by the end of this week or early next. The issues to be addressed at HUD's hearing include the exemption for employer/employee referral fees, the appropriateness of buyers making referral payments under computerized loan origination systems, the provisions relating to pre-emption of state laws in this area, and the question of whether the provisions calling for disclosure of controlled business arrangements adequately protect consumers.

While HUD's decision to hold a hearing on these issues is one that was arrived at independently from this hearing, I am pleased that HUD appears to agree that the circumstances in which the regulations were promulgated last year raise legitimate questions about whether another look is appropriate. I hope that today's hearing can help focus the issues to be addressed during HUD's review of these matters.

The Committee will hear from a panel representing a variety of groups on both sides of this issue, and I look forward to hearing their views. Before introducing our witnesses, however,

does any other Member of the Committee wish to make an opening statement at this time?

OPENING REMARKS OF THE HON. GLENN POSHARD
COMMITTEE ON SMALL BUSINESS
July 1, 1993

Mr. Chairman and members of the Committee, I am pleased to be here this morning to hear testimony about the impact of regulations under the Real Estate Settlement Procedures Act.

In November, 1992, the Department of Housing and Urban Development published regulations concerning controlled business arrangements and computerized loan origination systems. Also, HUD has recently developed a proposal for a final rule on referral fees under RESPA. I understand that the proponents of the new regulations believe they will promote efficiency and help consumers obtain more information regarding mortgages and other costs associated with real estate settlements. The opponents believe that the regulations will unfairly discriminate against small businesses.

I look forward to hearing from the panel so that we on the committee can have a better understanding of the diversity of opinions regarding these proposed rules.

Thank you, Mr. Chairman.

Testimony

of

Howard A. Birmiel

on behalf of

# CRISIS*

on

# Anti-Competitive Impacts of Referral Fees/Kickbacks & "Controlled Business Arrangements"

in
Residential Real Estate Settlements

Submitted at the

House Small Business Committee's
Hearing on HUD's RESPA Regulations

*July 1, 1993*

* "The Coalition to Retain Independent Services In Settlements"

**Statement**
**of**
**Howard A. Birmiel**
**on behalf of**

**CRISIS**

**before**
**House Small Business Committee**

*July 1, 1993*

Mr. Chairman and members of the Committee, my name is Howard Birmiel, and I am appearing here on behalf of the Coalition to Retain Independent Services in Settlements (CRISIS). Accompanying me for the purpose of responding to questions from the Committee are Mr. Joel Holstad and Mr. John Farmer, CRISIS members who are affiliated with the Independent Land Title Association of Minnesota. We deeply appreciate your holding this hearing.

Today, I will explain how HUD's new RESPA rules----which allow so-called "controlled business" firms to pay referral fees (i.e., kickbacks) to employees for steering settlement business to an affiliated company----will severely harm thousands of independent firms and will cause consumers to be overcharged millions for "something for nothing" service fees. By sanctioning such kickbacks, these RESPA rules guarantee that "controlled providers"----which are primarily captive affiliates of large, diversified firms----will have an unfair and insurmountable competitive advantage over independent settlement providers who are prohibited from paying referral fees.[1] Ironically, HUD's rules sanction precisely the types of consumer abuses that RESPA was passed to prohibit. Prompt action is needed by Congress and the Clinton Administration to correct this situation before large diversified businesses are able to use the rules to dominate completely the settlement services

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[1] Common sense provides the answers to practical and policy questions, such as the following, raised by this controlled business/referral fee issue:

(1) If an employee in a controlled business arrangement can receive a significant fee or other personal economic benefit for referring business to an affiliated settlement service provider, but can not be paid anything for referring the business to an independent provider, what will most employees do?

(2) If employees in controlled arrangements refer most of their business to captive affiliates because of such referral fees, doesn't this mean independents will be unfairly cut out from a large segment of the settlement services market?

(3) Are consumers likely to be adversely effected if thousands of independent small business competitors are driven out of business by these anti-competitive RESPA provisions?

(4) Are consumers' interests better served when a real estate professional makes a referral based on who will provide the consumer with the best price and service, or when the referral involves an inherent conflict based on the economic benefit (e.g., a kickback) received by the referring party?

(5) When an employee of a controlled business recommends that a consumer use an affiliated title agency or other controlled settlement provider is this a valuable "service" to the consumer that merits compensation, or are fees for such recommendations really unjustified "something for nothing" payments that unnecessarily inflate consumers' charges?

(6) If referring consumers to settlement providers is considered to be a service for which a controlled business may pay its employees compensation, should not independent providers also be allowed to pay such referral fees? Does this invite a return to what led to RESPA in the first place?

marketplace. Reforms must include both regulatory changes by HUD and new legislative safeguards to prevent controlled business arrangements from circumventing Congressional intent.[2]

I am a small businessman from northern Virginia. I employ eight persons. I have a title insurance agency and provide legal services in connection with residential real estate closings. The vast majority of settlement services in the Washington area and in many other parts of the country historically have been provided through independent small businesses like my own.

CRISIS was formed to represent the interests of such small independent businesses that provide the various discrete services needed in connection with residential real estate settlements. These services include, for example: title insurance agencies; escrow services; mortgage brokerage; mortgage lending; homeowners' insurance; surveys; appraisals; home inspections; and real estate settlement legal services. Thousands of such small businesses exist throughout the nation. A large segment of these independent firms would be forced out of business if pro-competitive, pro-consumer reforms are not adopted.[3]

Let me make it clear that we independent settlement service providers compete intensely for business on the basis of price, service and quality. We would be happy to compete with controlled providers on that basis any day. Unfortunately, we can not do so if controlled business organizations are allowed to pay something-for-nothing referral benefits. This distorts the market's natural competitive forces. It makes referrals flow on the basis of the kickback to the real estate professional instead of the price and quality of the product or service being provided. Such self-referrals guarantee that "controlled businesses" ultimately will control the settlement business.

## I. The "Controlled Business" Referral Fee Scheme

HUD's RESPA regulations which are of concern here became effective on December 2, 1992, only 30 days after being issued.[4] They contain the unexpected twist of allowing certain companies----primarily large diversified real estate brokers or mortgage lenders----to pay referral fees or other self-enrichment benefits to their employees for steering title insurance and other residential settlement work to a captive or so-called "controlled" affiliate.[5] While such payments for

[2] As indicated by the two letters attached as Appendix "A", the House and Senate Banking Committees have expressed concern to HUD over these RESPA rules, but have not yet scheduled hearings or taken legislative action.

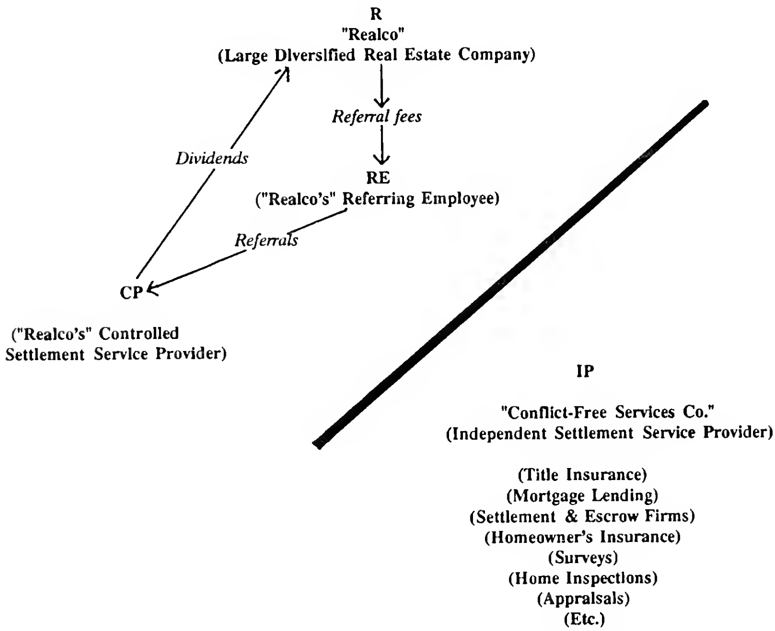
[3] CRISIS is joined in its efforts in opposing these RESPA provisions by the following organizations: National Association of Mortgage Brokers ("NAMB"); Consumer Federation of America; Independent Insurance Agents of America ("IIAA"); American Land Title Association ("ALTA"); California Escrow Institute ("CEI"); Savings and Community Bankers Association ("SCBA"); Mortgage Bankers Association ("MBA"); Florida Association of Independent Title Agents; Independent Land Title Association of Minnesota; and H.F Ahmanson Company.

[4] 24 C.F.R. Section 3500.14(g)(2)(ii), published in the Federal Register on November 2, 1992.

[5] CRISIS has grave reservations with the Computerized Loan Origination ("CLO") provisions in HUD's new RESPA rules, as well. However, for purposes of this hearing we shall defer to the Mortgage Banker Association to address this issue in its testimony. Suffice it to say, for the main part, that we feel CLO's invite realty firms to take advantage of their special relationship with consumers and steer their selection of potential mortgage providers to a limited group of favored and perhaps, affiliated, concerns

self-referrals within these so-called "controlled business arrangements" are allowed, referral fees can not be paid by independent providers to obtain settlement business. These new rules reverse HUD's position against such self-enrichment schemes. They are an administrative attempt to rewrite the RESPA statute and delete its safeguards against these types of unnecessary charges.

**The following illustration shows how this referral fee/kickback scheme works:**




"Realco" pays its employee referral fees/kickbacks whenever he or she refers settlement business to "Realco's" controlled provider. The increased profits generated by controlling the ancillary settlement work are then passed up as dividends to "Realco" which uses these profits to compensate for its paying kickbacks to employees. It makes no personal economic sense for "Realco's" employees to refer any business to small independent providers like "Conflict-Free Consumer Services Co." Therefore, "Realco's" employees will refer virtually all settlement work to "Realco's" controlled provider and the independent providers have no way to compete in this controlled business market.

## III. History of RESPA's Prohibition on Referral Fees

Congress has recognized that most consumers rely on their real estate professional's recommendations in selecting firms to provide the various services needed in connection with residential real estate purchases. Experience has shown that such referrals are not likely to be made in the consumer's best interest when real estate professionals are allowed to pay referral fees and other kickbacks. In the early 1970's, exposes in the Washington Post, as well as a joint HUD-VA study, disclosed that abusive and unjustifiable settlement charges, kickbacks and conflicts of interest were rampant in the real estate settlement services industry. When Congress considered this issue in 1974, it found:

> *"In a number of areas of the country, competitive forces in the conveyancing industry have led to the payment of referral fees, kickbacks, rebates and unearned commissions as inducement to those persons who are in a position to refer settlement business. * * * In all of these instances, the payment or thing of value furnished by the person to whom the settlement business is referred tends to increase the cost of settlement services without providing any benefits to the homebuyer. * * * [I]t is the intention of [RESPA Section 8] to prohibit such payments, kickbacks, rebates, or unearned commissions."*

Congress acted to prohibit such abuses by passing RESPA with the overriding purpose, set forth in Section 2(b)(2), of seeking *"the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services."* Congress included an express prohibition in Section 8(a) that:

> *"No person shall give and no person shall accept any fee, kickback or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."*

## IV. 1983 "Controlled Business" Amendment

During the 1970's, several large national real estate brokerage companies established affiliated firms that provided title insurance and other settlement services. The existence of these "controlled companies" raised issues such as whether the parent brokerage firm could even receive a dividend from its controlled affiliate because this might be deemed to be a prohibited "thing of value" in violation of RESPA's Section 8(a). Congress examined this controlled business development and sought in 1983 to clarify that such controlled arrangements were a permissible method of doing business if certain safeguards were followed. It added a new Section 8(c)(4) which states that Section (8) shall not be construed as prohibiting controlled business arrangements so long as: (A) homebuyers receive disclosures of such arrangements; (B) homebuyers are not required to use the controlled business services; and (C):

> *"the only thing of value that is received from the arrangement . . . is a return on the ownership interest or franchise relationship."*

RESPA defines "ownership interests" narrowly as a "dividend" or "partnership distribution," and it prohibits payments based on the mere fact or volume of referrals. Congress' intent to limit this

"controlled business" provision and to continue the application of Section 8(a)'s prohibitions was clearly stated in the House Banking Committee's report:

> *"[T]his provision is not intended to change current law which prohibits the payment of unearned fees, kickbacks, or other things of value for referrals."*

## V. HUD Rule Changes After Last-Minute Intervention

Although the "controlled business" clarification was added in 1983, HUD failed to issue implementing regulations until last November, nearly 10 years later. When these rules were finally issued, HUD authorized "controlled business" firms to pay referral fees to their employees, in direct contradiction of RESPA's plain meaning and primary purpose. HUD's stated rationale was that:

> *"[P]ayments from an employer to its employee for referral activity are exempt from Section 8 because a business entity acts through its employees such that the action of the employees is not sufficiently distinct from the action of the employer to provide the requisite plurality of actors needed to violate Section 8 of RESPA."*

In effect, HUD contended that Section 8's prohibition on kickbacks requires two separate parties and that a company and its employees are not distinct so paying kickbacks in these circumstances is not illegal.

The "controlled business" self-referral fee provisions in HUD's regulations were inserted at the last-minute after intervention from several large diversified real estate firms. Proposed regulations in 1988, and three draft final versions of these RESPA regulations, in 1988, 1990 and 1991, gave no hint that the controlled business concept would be used to authorize and encourage steering settlement business to controlled providers by allowing self-referral fees and other benefits. In fact, the draft rules expressly stated that such payments were prohibited (e.g., the "*exemption ... does not permit an entity to pay employees of an affiliated entity to refer business to the first entity, nor an entity to pay its own employees to refer business to an affiliated party*"). This theme was echoed in several informal opinion letters issued by HUD's General Counsel's office between 1988-1991.

HUD's professional staff have confirmed, as was first reported in the Washington Post,* that high-level forces took the matter out of their hands, and summarily reversed HUD's long-standing policy against such payments. HUD then rewrote the rules to allow controlled businesses to pay such fees and benefits. This bypassed the normal rulemaking process and violated proper administrative procedures established by law.

* On October 31, 1992, The Washington Post quoted the Executive Director of Vice President Quayle's Competitiveness Council as boasting that these RESPA changes were made after the Council intervened in this rulemaking. One of President Clinton's first acts was to abolish this controversial group, stating that the Council had "enabled regulated industries to thwart Congressional intent on key environmental and consumer protection laws."

## VI. The White House Paper Trail and HUD's Letter

CRISIS and the Mortgage Bankers Association are challenging HUD's actions in lawsuits filed here in federal District Court.[7] In the course of the litigation, we obtained documents showing the paper trail of involvement by OMB and senior White House staff in the closing days of the prior Administration.

One of the most revealing documents unearthed thus far in this litigation is a fascinating August 7, 1992 letter[8] from HUD Deputy Secretary Alfred DelliBovi to OMB. That letter, which our discovery confirms was faxed by OMB to the White House Counsel's office, disclosed that HUD's own legal opinion was that paying referral fees to controlled businesses' employees was illegal:

> *"[T]he General Counsel has determined that employers may not compensate employees who refer business to affiliated companies, because such referrals are prohibited under RESPA sections 8(a) and 8(c)(2), even where the provisions of the "safe harbor" in section 8(c)(4) have been met."*

In the late summer of 1992, after the White House staff obtained this HUD letter, things changed substantially. HUD revised its rules 180 degrees to permit such fees. HUD also revised its Regulatory Impact Analysis (RIA), which it issued October 30, 1992, just before the rewritten regulations were published. The RIA purports to estimate the costs and benefits of the new regulations. It appears to rely heavily upon data supplied by the National Association of Realtors (NAR), many of whose members could benefit from referral fees (See, e.g. RIA at 8, referring to NAR's "excellent data"). This RIA is premised on economically irrational assumptions and unsupported suppositions.

Let me briefly illustrate the strange reasoning processes used in this document. The RIA concluded that the seven largest realty firms, which execute 38% of all home sales, and some other firms that have at least one affiliate settlement provider, together can soon be expected to refer 45% (and at other times, it inexplicably says 55%) of the settlement business to their captive affiliates. These estimates are far more conservative than what we expect to happen in the marketplace. Nevertheless, even HUD's own percentages show that half of the market will soon be controlled by controlled providers. Obviously, this will have a devastating impact on small independent businesses that now provide the vast majority of such services in many market areas. Despite this fundamental change in the market, HUD certified in the RIA that "this rule would not have a significant economic impact on a substantial number of small entities." That makes no sense.

In addition, our co-plaintiff MBA uncovered an internal document on Sears Mortgage Corporation letterhead, which apparently was sent to Coldwell Bankers' offices under the rubric of

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[7] Amicus Curiae briefs supporting CRISIS and MBA have been filed by the Consumer Federation; IIAA; SCBA; CEI; and NAMB. Ahmanson has advised the Court that it will be filing an amicus brief, also.

[8] A copy of this letter is attached as Appendix "B."

"Winning Sales Ideas." The author suggests the wave of the future: Sales managers are advised to discard independent lenders' literature and to freeze out real estate agents from getting new buyer referrals unless they refer buyers to Sears Mortgage Corporation. They further attempt to capture mortgage business for Coldwell listings by recommending that buyers' offers only be accepted by the seller if the buyer first obtains pre-qualification from Sears Mortgage.[9] Such practices will only proliferate now that controlled businesses can pay referral fees openly.

I will not take more time in my statement to recount further the serious flaws in HUD's position. For purposes of clarifying the historical record of HUD's revision, I refer the Committee to the pleadings filed in our lawsuit and to the October 31, 1992 article in the Washington Post, reporting that the Competitiveness Council also claimed "credit," if it can be called that, for these changes. And, to elaborate on the historical and legal implications of HUD's action, I will refer the Committee to the attached declaration of Georgetown Law Professor William Eskridge, Jr., which effectively shreds the RIA's manufactured conclusions of consumer benefits and limited market impacts on small providers.[10]

## VII. The Need for Consumer Protection

We are testifying today primarily from our perspective as small businesses. Therefore, we have focused on the severe harm the controlled business referral fee rules will do to small independent settlement service providers. However, we also feel compelled to point out that consumers will ultimately suffer the greatest injuries if these misguided rules are allowed to stand. Proponents of controlled business and referral fees are quick to try to paint a rosy picture of such "one-way steering" arrangements providing consumers with "one-stop shopping," greater conveniences and discounts on packages of services. Consumer groups have dismissed such fanciful claims. They have given us the real world picture that shows the serious consumer injuries that will occur if these controlled business schemes are allowed to operate on a tilted playing field.

The Consumer Federation of America (CFA), which consists of more than 240 consumer, cooperative and pro-consumer organizations nationwide whose combined membership totals more than 50 million persons, recently filed an amicus curiae brief. CFA strongly supports CRISIS' (and the Mortgage Bankers Association's) position in our pending litigation with HUD. The Consumer Federation's brief explains that referral fees and kickbacks inflate the costs of settlement services without providing any commensurate benefit to consumers. Moreover, it points out that consumers are adversely affected when referrals are based on kickbacks or other fees paid to real estate professionals because such payments skew competition in directions that do not serve the consumer's best interest. The following excepts from the Consumer Federation's amicus brief in the pending litigation against HUD's new RESPA regulations clearly describe why and how consumer injuries will occur:

> *"The real injury consumers suffer when kickbacks and other kinds of financial inducements are allowed to influence the referral of the consumer's settlement business is not simply that such*

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9 A copy of this document is attached as Appendix "C."

10 A copy of the Eskridge declaration is attached as Appendix "D."

*payments by themselves inflate the cost of settlement services. It is the fact that such payments fundamentally alter the nature of market competition to the detriment of consumers. Instead of having settlement service providers competing in ways that serve the consumer's interest, competition is channeled in directions that serve the personal financial interest of the real estate professionals who are in a position to influence the consumer's selection or to make that choice for him.*

*The purchase of settlement services confronts consumers with problems that they do not face in most other areas where they have knowledge and ability to shop effectively on their own for the provider who offers the best combination of price, quality, and service. Most consumers buy a home only once or twice in their lives; they have little or no familiarity with the purchase of the kinds of services needed in connection with the real estate transaction; and they frequently do not have the time between the signing of the purchase contract and the closing to become knowledgeable shoppers for services that they may never again need.*

*Given these factors, it is inevitable that consumers will look to and rely upon the recommendations or referrals of their real estate broker or the mortgage lender. These professionals have the knowledge and experience that the consumer lacks; these people are involved in real estate settlements all the time and are in a position to know the quality and value of the service providers in the market. Accordingly, in the overwhelming number of residential real estate transactions the selection of a title company or other settlement service professional is made on the basis of referrals from brokers, lenders and other real estate professionals.*

*If the broker's or lender's recommendation cannot be influenced by a referral fee or other personal financial inducement to steer the business to a particular company, then referrals will be made on the basis of which provider can best serve the consumer's interest. Competition among settlement service providers -- who know that they have to compete for the referrals of these knowledgeable surrogate shoppers on the basis of the competitive merits of their products and services -- will thus be channeled in directions that serve the best interests of consumers.*

*It is this kind of competitive environment that Congress sought to foster in enacting section 8. While the 1983 amendments determined that referrals to controlled business affiliates were not violations of section 8 if certain prescribed conditions were met, Congress did not otherwise intend that the basic consumer-oriented thrust of section 8 was to be altered. But this is precisely what HUD's employer referral fee and CLO rules would do.*

*The employer referral fee rule encourages employees of brokerage firms and mortgage lenders to steer the consumer to the employer's controlled business affiliate even if other firms can provide better prices, quality or service. It is simply unrealistic to believe that allowing such payments will not determine the direction of referrals. Moreover, the controlled business affiliate does not have to compete on the merits for the recommendation of that employee when the affiliate knows that the employee will be receiving a direct financial incentive from his employer to steer business its way. As a consequence, consumers will not only end up having to pay for such fees, but the entire dynamics of competition among settlement service providers becomes altered to the detriment of consumers. Indeed, if controlled business arrangements continue to develop, and employer referral fees are permitted to be paid to ensure that consumers get steered to the broker's or lender's affiliate, there is a great danger that few if any consumers will be able to escape the one-way highway of financially-induced referrals to captive affiliates."*

We realize that the idea of referral fees--easy money--sounds good to various trade groups, especially some of the realty associations. Yet before HUD opened the floodgates, such groups as the Northern Virginia Board of Realtors, the largest local real estate trade association in the country, were on record as opposing any types of referral fees, because they *"inevitably creat[e] situations ripe for conflicts of interests between real estate agents and their customers."*[11]

## VIII. Reports of Abuses Occurring

There is no shortage of reports of abusive "under-the-table" practices perpetrated by controlled business-type entities, which have sought to pressure their real estate agents or loan officers to steer business in-house, and HUD's new RESPA rules will only increase the problems. CRISIS has received information indicating widespread patterns of anti-competitive practices that threaten small business and, not coincidentally, lead to consumer overcharges.

For example, in the Minneapolis-St.Paul, Minnesota area, the two largest real estate firms, Edina Realty and Burnett Realty, control over 50% of the residential real estate market, and have formed mortgage and settlement affiliates. Joel Holstad, of National Title in White Bear Lake, Minnesota, who is here today to answer any questions the Committee may have, has advised us that he has had a substantial decline in business for several years because Edina and Burnett encourage their staff to send the settlement business to their affiliates. For example, Edina reportedly encourages persons to send closings to its controlled affiliate, Equity Title, by such practices as paying commissions at the settlement table, without disclosing the tie-in relationship with its settlement affiliate. Independents, such as Mr. Holstad, whose settlement prices average about $75 less than the Edina and Burnett controlled affiliates, cannot even gain access to the realtors' offices. In addition, we have been told that Edina Realty has paid bonuses to sales managers to influence its brokers to send business to Equity Title. Burnett also reportedly promoted salespersons into its management-track program, with the condition that they use its controlled title company, First Security.

Another illustration of the anti-competitive practices that are occurring is the situation experienced by Debbi Faber of Niguel Escrow in South Orange County, California. Mrs. Faber has already been driven out of business by controlled businesses. I urge you to read the attached letter from Ms. Faber which explains how her business suffered at the hands of realty brokerages who own or have a tie-in with an escrow company.[12] These brokerages give incentives to send the settlement business to the escrow tie-in, through lower or waived desk fees, advances on commissions, and higher commissions for using the affiliates. In addition, only two firms in her geographic market do not have a tie-in with an escrow company. She reports that most of these that have such relationships, such as Coldwell Banker, have a "closed door" policy excluding the independents from coming to their offices and introducing themselves and their service.

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[11] A copy of this document is attached as Appendix "E."

[12] A copy of Ms. Faber's letter is attached as Appendix "F."

Numerous other issues of concern are outlined in the attached excerpts from CRISIS' Answers to Interrogatories that have been filed in our pending lawsuit against HUD.[13] It is apparent that we are only seeing the tip of the iceberg. Another indication of this comes from HUD's recent announcement----claiming as a great consumer victory----the simultaneous filing and settlement of an administrative proceeding charging Coldwell Banker and its various affiliates with wholesale steering violations of RESPA in New Jersey and Minnesota. The enforcement case, which was brought after CRISIS filed its lawsuit, was settled by a "consent" order, in which Coldwell Banker denied all allegations. Our general sense of the settlement market leads us to believe that there is a great degree of truth in what HUD alleged in its May 17th news release: *"[Firms] engaged in practices to steer consumers to other affiliated companies and that they got kickbacks for the referral of business, and they also received unearned fees."* [14]

## IX. Legislative Reforms Must Be Adopted

In closing, I want to emphasize that it will not be adequate to merely withdraw and reissue these flawed HUD regulations with a prohibition on referral fees. To be sure, that would be necessary and helpful step to prevent unfair competition and consumer abuses. However, HUD's issuance of these rules eight months ago, and the ensuing publicity alerted firms as to how easy it is to profit through controlled business arrangements. We have no doubt that such controlled businesses in many cases will provide a ready vehicle for covert circumvention of RESPA's prohibition on referral fees and other kickbacks. There are many undisclosed payments and economic benefits that can be paid to real estate agents and lenders to refer business to an affiliate. Policing such kickbacks will be extremely difficult, if not impossible, especially since HUD has only a very small enforcement staff. California and several other states like Minnesota experienced many of these problems well before HUD's controversial new regulations were issued.

Thus, CRISIS believes that the only effective way to protect against such controlled business abuses is to pass additional legislative safeguards. Congress should impose limitations on the amount of business that can be referred to a controlled affiliate and tougher penalties for violations of the anti-kickback provisions. In addition, HUD's RESPA enforcement staff, which is quite dedicated to preventing abuses, is quite small. Try as they might, this limited staff can not effectively handle the large number of cases that are arising and will arise. Congress should significantly increase the size and resources of HUD's RESPA enforcement office.

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[13] This material is attached as Appendix "G."

[14] A copy of HUD's news release is attached as Appendix "H."

# Appendix A

# United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

March 1, 1993

The Honorable Henry Cisneros, Secretary
Department of Housing and Urban Development
451 Seventh St., S.W.
Washington, DC 20410

Dear Secretary Cisneros:

On November 23, 1992, we wrote former Secretary Kemp to express concerns regarding the final HUD rule for the Real Estate Settlement Procedures Act (RESPA). A copy of our letter is attached. The RESPA rule issued on November 2, 1992, represented a significant change from the public positions taken by the Department in testimony before the congressional committees prior to that time. Moreover, the hasty manner in which the revised final rule was promulgated and rushed to implementation suggests that important issues of consumer protection may not have been adequately addressed. Because of these concerns, we requested in our November 23rd letter that then-Secretary Kemp delay implementation of the rule for six months to allow for a review to take place.

Unfortunately, our request for delay in implementation was not acted on before the rule went into effect. Nevertheless, the competitive and consumer protection implications of that rule are still a concern. With this letter, we urge you to undertake a thorough review of the final RESPA rule.

Thank you in advance for your attention to this matter. Please keep our offices informed of your progress on this review.

Sincerely,

Senator Donald W. Riegle

Congressman Henry B. Gonzalez

Senator Paul S. Sarbanes

United States Senate

WASHINGTON, DC 20510

November 23, 1992

The Honorable Jack Kemp, Secretary
Department of Housing and Urban Development
451 Seventh Street, S.W.
Washington, DC 20410

Dear Secretary Kemp:

On November 2, 1992, the Department issued a final rule revising regulations for the Real Estate Settlement Procedures Act (RESPA). This final rule is scheduled to become effective on December 2, 1992. For the reasons stated below, we are writing to urge you to delay implementation of this rule until April 28, 1993, the implementation date established by Section 908 of the Housing and Community Development Act of 1992.

As you are aware, RESPA was enacted in 1974 to protect consumers from unnecessarily high settlement costs arising from abusive business practices by some in the real estate community. The November 2nd rule makes several changes in Regulation X, including providing an exemption from Section 8 of RESPA -- which prohibits kickbacks or referral fees -- for Computer Loan Origination Systems (CLOs). The rule generally reflects HUD's conclusion that "there [are] potentially substantial consumer benefits in the utilization of new technology."

We are concerned about the adequacy of the consumer protections contained in the November 2nd rule. In several significant respects, the rule represents a departure from the Department's strong assurances on this issue in the past.

For instance, in testimony before the Senate Subcommittee on Housing on September 19, 1990, HUD General Counsel Francis A. Keating expressed the Department's intention "to allow for the introduction or expansion of CLOs, subject to specific limitations and conditions and careful review." Mr. Keating also noted that:

> "Secretary Kemp has tried to look at this issue from the standpoint of the potential users of the service -- the consumer. We must remember, after all, that it was for the consumer that RESPA was created. <u>The arguments of those interests which perceive that they stand to gain or</u>

loss from one regulatory action or another must be secondary to the long-term interests of the consumers of the service." [emphasis added]

Mr. Keating's testimony went on to identify some of the consumer protection provisions that would be included. He noted that:

"...we intend to propose that all realtors who offer computerized loan originations be required to offer the products of multiple lenders...The Department intends to assure that any system accessible from a realtor's office would display loans from competing lenders, and that a homebuyer who did not leave one particular realtor's office to obtain loan information or apply for a loan would have more than one lender from which to choose.

...In addition, we will require -- permanently -- that the realtor disclose to the homebuyer that he or she will receive a fee for the CLO service and further disclose that there are other lenders, not on the CLO system, who may offer more favorable terms.

...The Department proposes to establish a limit on fees for CLO services. We believe that the fee should be capped at a fixed dollar amount, which would be set to reflect the reasonable cost of providing such a service."

Mr. Keating made almost identical commitments to the House Subcommittee on Housing and Community Development in his testimony before that committee on September 18, 1990. These protections were also included in the final rule "leaked" in January 1991, but never published.

Despite the Department's strong and definitive position regarding CLOs and consumer interests in 1990, the November 2nd rule fails to include two of the requirements cited above; namely the requirement that more than one lender be listed on the CLO service and the cap on fees for CLO services. Significantly, the final rule fails to provide any explanation for the Department's decision to reverse its previously stated position on this issue.

Although the final rule notes that the Department believes that "...well-informed choices by consumers do not require special protection under RESPA," we are concerned that the rule does not provide sufficient protection against the kinds of abuses RESPA was designed to prevent.

Finally we must note the extremely short time frame that the Department has set for implementation of this rule. Although the proposed rule was issued in May 1988 it has taken more than four years for the Department to issue a

final rule. We believe that this underscores the complexity and seriousness of this issue and the other issues addressed in this regulation. Under these circumstances, a longer time period prior to implementation would be more appropriate.

Given these significant changes we urge you to delay implementation of the final rule until April 28, 1993. This will allow the new Administration to carefully review the consumer protection provisions of the regulation. It will also enable the Department to promulgate one set of RESPA regulations, including the CLO rules as well as those changes included in the Housing and Community Development Act of 1992.

Sincerely,

Donald W. Riegle

Henry B. Gonzalez

Alan Cranston

Paul S. Sarbanes

# Appendix B

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE DEPUTY SECRETARY
WASHINGTON, D.C. 20410-0050

August 7, 1992

Mr. James McRae
Acting Administrator and Deputy Administrator
Office of Information, Regulatory Affairs,
Management and Budget
New Executive Office Building
725 17th Street, N.W., Room 3236
Washington, D.C. 20503

Dear Mr. McRae:

I am transmitting for your review a copy of the revised Regulation X, an Interim Rule implementing the Real Estate Settlement Procedures Act, 12 USC 2601 et seq. (RESPA).

The revised rule has been subjected to exhaustive review and deliberation by the top legal and policy officials of this Department. Despite this, there remain strong differences of opinion over several provisions of the revised rule.

The rule and preamble submitted reflects the General Counsel's position on what is necessary to comply with the letter of the RESPA statue, notwithstanding policy preferences to the contrary. In particular, the General Counsel has determined that employers may not compensate employees who refer business to affiliated companies, because such referrals are prohibited under RESPA sections 8(a) and 8(c)(2), even where the provisions of the "safe harbor" in section 8(c)(4) have been met. The interim rule reflects this legal position even though it conflicts with our policy preference to encourage the growth of affiliated services.

The Department of Justice, Office of Legal Counsel, has been asked to confirm this view. If the Department of Justice's opinion provides greater policy latitude than is contemplated in this rule, HUD will submit a revised package in line with our policy objectives.

Given the long history of this rule's development, I believe that it is more prudent to transmit the rule now rather than further delay action until we hear from Justice. For the same reason, we are sending you this rule before we have completed a section addressing escrow account issues. This section will be provided to you shortly.

Appropriate members of our staff will be available to brief you on any aspect of this rule. I appreciate your assistance in reviewing this important regulatory document.

Sincerely,

Alfred A. DelliBovi

PLAINTIFF'S

March 30, 1993

MEMORANDUM

To: Secretary Henry Cisneros

From: CRISIS - The Coalition to Retain Independent Services in Settlements

Re: HUD's RESPA Rules Should Be Amended To Prohibit "Referral Fees" and New Safeguards Should Be Adopted Regarding "Controlled Business Arrangements"

In the closing days of the Bush Administration, HUD issued final regulations[1] implementing 1983 Amendments to the Real Estate Settlement Procedures Act ("RESPA"). The drafts of these new RESPA rules were changed at the last minute after political efforts by several large real estate firms through Vice President Quayle's Competitiveness Council so as to reverse long-standing federal policy and in effect overturn RESPA's prohibition against fees and kickbacks for referring business incident to real estate settlements.[2] The rules adopt the perverse view that the statute's "controlled business" amendment passed in 1983 allows real estate firms to pay their employees referral fees for steering residential settlement services work (like title insurance) to a firm they control.[3] Even HUD's General Counsel advised that this new position violated the statute, but political pressures prevailed. (See DelliBovi letter copied on reverse.)

Such "something for nothing" self-referral fees are precisely the type abusive practice that RESPA was passed to stop. If allowed to stand, these anti-competitive HUD rules will soon cause a fundamental change in the market, costing consumers millions of dollars in unnecessary settlement fees while decreasing services' quality and integrity and driving most smaller independent service providers out of business. Larger, vertically integrated firms will be able to lock-up for themselves much of the residential settlement business.

The Clinton-Gore Administration should act now to ensure changes are made by HUD and safeguards added to protect consumers from unjustifiable fees and small businesses from unfair competition from "controlled" provider organizations. The new rules should be suspended, and Congress also should be urged to pass additional limitations on "controlled business" arrangements.

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[1] 24 C.F.R. Sec. 3500.14(g)(2)(ii), published in the Federal Register on November 2, 1992.

[2] RESPA was passed in 1972 after investigations revealed that kickbacks, unmerited referral fees and similar abusive practices were rampant in the settlement business. Section 8(a) of the Act provides that: *"No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."*

[3] **1983 "Controlled Business" Amendment** - A limited exception was added to RESPA in 1983 which changed Section 8(c)(4) of the Act to permit referral benefits to be paid or given under a "controlled business arrangement" structure. These arrangements essentially involve real estate professionals (e.g., brokers, mortgage lenders) having an ownership interest in title agencies or other settlement service providers to which they can steer their customers to purchase their necessary settlement services from such in-house affiliates. Congress clearly intended the exception to be quite narrow----it permitted payments in a controlled business structure only if (1) the affiliation is *disclosed* to the home buyer; (2) the home buyer is *not required* to use the controlled provider; and most importantly (3) *no monies or other benefits* are passed between the parties who make and receive the referral *except for a return on an ownership interest* in the business. An ownership interest is defined as dividends or partnership distributions, and payments based on the mere fact or volume or referrals are prohibited. Congress' intent to restrict this "controlled business" provision was clearly stated in the House Banking Committee's report: *"[T]his provision is not intended to change current law which prohibits the payment of unearned fees, kickbacks, or other things of value for referrals."*

# Appendix C

I - 187

SEARS MORTGAGE CORPORATION

DATE: May 30, 1991

TO: Field Distribution

FROM: J. Joseph Heaian

RE: Coldwell Banker Mortgage Usage

A copy of a letter dated May 7, 1991, from Robert J. Arrigoni, Senior Vice President, Coldwell Banker Residential (CB) to the CB Operating Officers will be provided in the Friday pouch. The letter addresses the issue of how CB will provide IPP credit to their Managers for loans referred to Sears Mortgage Corporation. The pertinent points are as follows:

1. CB will give IPP credit to their Branch Managers for refinances on a 2 for 1 basis (i.e., 2 refinance applications will have the same value as 1 purchase money mortgage).

2 Full IPP credit will only be given where CB is the seller or lister. No IPP credit will be given for applications that are initially referred to SMC by CB and are subsequently financed by SMC but CB is neither the listing or selling broker.

It will not be necessary for individual SMC offices to report the number of refinance applications to CB. A print out by referral source code will be provided to CB in Mission Viejo; however, in order to report the number of refinance applications to CB, it will be necessary to enter these into MLAPS using the proper CB Referral Source Code. The official Usage Report will be adjusted on a gross basis each month to delete refinances from the final usage figures i.e., there will be a total adjustment for each branch/sales office; however, the individual CB offices will not be adjusted on the report. If you have any questions, please contact your Senior Regional Manager.

JJH/sew
cc: B. Arrigoni
A. Perriello
A. Ringwald
M. Uhlik

052291.5

B202

SEARS MORTGAGE CORPORATION

DATE December 9, 1991

TO Cincinnati Loan Officers, Coldwell Banker Cincinnati Managers

FROM Judy Kinser

SUBJECT QUESTIONS AND ANSWERS.

What are ways Sears Mortgage Corporation can help Coldwell Banker sell more homes and get more listings?

* Competitive Rates, Costs and excellent service and an open line of communication between all parties.

How do you support Sears Mortgage Corporation in your office both in actions and words?

* Utilizing the Loan Officer for training and constant availability to agents.

* Give direction to the agents to use Sears Mortgage Corporation's Products.

How do we increase Sears Mortgage Corporation usage on listings sold?

* The agent should ask the Co-op where the loan's going.

* Make the acceptance of offer contingent on the Buyer getting pre-qualified by Sears Mortgage Corporation and/or do approval 1st.

* Need an incentive program for the agent to give us the opportunity (point system, etc.).

* Print up a card to include with acceptance of contract to show buyer the benefits of using Sears Mortgage Corporation.

* Initiate a Reward Program for each agent, from Sears, not just their Manager, on a weekly basis (lottery ticket, etc.).

* Tell the agents at the beginning of the year what they can win (trip to Las Vegas) so they can keep shooting for increased % of yearly usage.

* The winners of prizes should get more publicity when they win.

* Sears Mortgage Corporation should sponsor a cocktail party for the 18K drawing.

B203

How do we get top and seasoned agents to use Sears Mortgage Corporation?

* Stop letting other Loan Officers into the office. Let them leave their rate sheets at the duty desk and then pitch them out immediately after they go. The Loan Officer should be made aware of Sears Mortgage Corporation to dissuade them from coming back.

* Talk about horror stories of other lenders and success stories of Sears Mortgage Corporation.

* Sears referral business should be routed thru Sears Mortgage Corporation. You have to get them at least pre-qualified if not approval 1st.

* Coldwell Banker must make the Loan Officer visible in the office - own office , space, display area and etc.

* Loan Officers need to visit open houses to encourage the agents.

* Sell the agents on Sears Mortgage Corporation's Pro-Act.

* Need to wine and dine the agents just like a Loan Officer from another company. Need to play and have fun outside of business.

How do you change agent behavior toward Loan Officer competitors with whom they have long term relationships?

* Broadcast Sears Mortgage Corporation's successes and find out what really happened on sour deals and advise the Loan Officer to sell his or herself first and Sears Mortgage Corporation second.

* Testimonials from successful agents "It's good business because they are part of the family."

* Become competitive with better points and rates and make Sears Mortgage Corporation more visible in the agent's listing presentation.

* Increased combined advertising, i.e. showing rate comparison in an inset ad.

* Stress Approval First and use $25.00 fee to their advantage.

* Pre-qualifying interviews within 24 hours.

* Entertaining a $200.00 off Coupon.

cc: Joe Healan

B204

SEARS MORTGAGE CORPORATION

| | |
|---|---|
| DATE | NOVEMBER 21, 1991 |
| TO | SALES STAFF |
| FROM | RICH KILFOID |
| SUBJECT | SALES IDEAS |

For your information, enclosed please find the sales ideas from the Kiawah Island Conference. Please review.

## *WINNING IDEAS...*

**How do you market ApprovalFirst to attract more buyer prospects?**

- Hold a buyer/seller seminar week with SMC featured on the agenda.
- Conduct a mass mailing to apartment dwellers about ApprovalFirst.
- Conduct a telethon to offer ApprovalFirst.
- Advertise ApprovalFirst with mail-back cards.
- Have applications available at open houses and at all active listings.
- Have the Sears Mortgage loan officer call prospects who attended open houses.
- Provide co-brokers with applications when they pick up keys from the office.
- The area manager, loan officer, branch manager and regional manager should hold their own Mortgage Planning Meeting.
- Educate sales associates on the benefits ApprovalFirst offers them (ie: a buyer loyalty tool) and their customers and train sales associates on how to sell the benefits of ApprovalFirst to their customers.
- Dedicate a page in the listing presentation book to ApprovalFirst.
- Dedicate a page in the Best Buyer Guide book to ApprovalFirst.
- Staple an ApprovalFirst form to the listing agreement.
- Staple an ApprovalFirst form to the Agency Disclosure form.
- Tell success stories at sales meetings.
- Provide as a service to FSBO - it will help get sales associate's foot in the door.
- Highlight-sheets left at homes should include information about Sears Mortgage.

*WINNING IDEAS...*

**How do you increase Sears Home Mortgage usage on listings sold by other brokers?**

- Include SMC information in the presentation book. Two ideas: 10 reasons to use SMC; ApprovalFirst passbook.
- The manager should call after an agent completes a competitive market analysis (CMA) visit to say "thank you for the opportunity to do a CMA" and to offer SMC services to potential buyers. Follow up with a letter from the manager.
- The listing broker or SMC loan officer can call the selling broker to offer SMC services.
- Because credit checks play such an important role today, market ApprovalFirst, especially with multiple offers.
- Market the fact that SMC can get credit information within hours and on weekends.
- Communicate that Sears Mortgage stands behind ApprovalFirst and will "fix it if it breaks."
- Selling brokers should be educated that Sears Mortgage will work just as hard for their buyer.
- Sell the fact that Sears, Roebuck and Co. and SMC stand behind their products and pride themselves on customer service. The ability to share SMC services with outside brokers will be benefit our entire industry.
- Ask agents to share success stories with other brokers.

## *WINNING IDEAS...*

**How do you counteract a competitor's well-established loan officer relationship with a Coldwell Banker office, especially when the SMC loan officer is new.**

Removing entrenched competition:

- Manage the office by having competitors leave flyers at the receptionist desk. Do not give them access to mailboxes, desks or individual agents.
- Meet with entrenched loan officer face-to-face to tell them you plan to support SMC.
- Never allow the loan officer to participate in seminars, breakfast meetings, etc.

Establishing a new loan officer:

- Match personality of the loan officer candidate with the personality of the office.
- Meet individually with the loan officer to set expectations for SMC services.
- Put stickers on every phone with the loan officer's phone and pager numbers.
- Suggest agents use ApprovalFirst on every loan as a way to get to know the loan officer.
- Give the loan officer his own desk, key, mailbox.
- Insist that the loan officer attend every sales meeting, tour, social function.
- Establish the loan officer as a "mortgage resource person."
- Have the loan officer provide a completed Grand Open House Kit and visit the open houses.
- Obtain an agent birthday list from Coldwell Banker and send cards or flowers.
- Make it very clear to agents at every sales meeting how important it is to support SMC and recognize agents' usage at every meeting.
- Broadcast success stories at every meeting.
- Have a Coldwell Banker/SMC display in the reception area that attracts agents' and buyers' attention.

## *WINNING IDEAS...*

**How do you increase SMC usage by top agents who are often successful because of their independent assertive style?**

- Meet with top agents one-on-one, ask them for their support and to give SMC a chance.
- Hold a business/social function, such as a brain-storming breakfast or winner's circle lunch, during which the top producers can meet with the SMC loan representative.
- Offer advanced financing classes taught by the SMC loan officer.
- Appeal to the control that top producers thrive on. Suggest that they require listings sold by other brokers to include an ApprovalFirst application as a condition for an accepted offer.
- Have the loan officer offer to attend open houses and do joint highlight sheets.
- Offer to do a joint farming program.
- Give top producers a Winning Combination pin or plaque.
- Have a monthly usage "honor roll" displayed in the office - top agents will want to be on it.
- Have the Sears Mortgage representatives supply special beeper codes to top agents to help them feel special.

## *WINNING IDEAS...*

**How do you overcome the reluctance of sales associates to use your "In house" mortgage operation? (This question was directed to members of the Affiliates Choice Program.)**

- In the beginning use a subtle approach.
- Hire quality mortgage people with the proper product knowledge and establish your standards right away.
- Hire mortgage loan officers that are successful with other mortgage operations – agents are already loyal to them.
- Broker/owner should review sales contracts to determine where agents are going for mortgages and then encourage SMC usage.
- Utilize ApprovalFirst. The mortgage representative can push this product PRIOR to the agent selling the house to the buyers.
- Do not give buyer referrals to agents who do not use Sears Mortgage.
- Communicate the "bottom line" profit side of business with agents to help them understand "the big picture."
- Recognize agents when they use the mortgage company. Highlight the sale in a different color on the production board.
- Manage the managers. Ask them how many buyer-control sales did not go through the mortgage company and why they did not.
- Tell success stories at meetings.
- Set up a good loan status system for agents so they know progress details at every stage.
- Show the steps that it takes to get a loan through SMC versus lender "X".
- Let the agents know that SMC will "bend over backwards" to make the loan. Let them know SMC management cares and Coldwell Banker can call any of the SMC people.
- Make sure in-house loan officers call on FSBO's.
- Use ApprovalFirst when meeting with sellers at a listing appointment.

*WINNING IDEAS...*

**How do you avoid problems in a Coldwell Banker office with an SMC loan officer quits?**

- The manager of the SMC office should call the Coldwell Banker manager first and fast.
- Preventative measures should be taken before the situation occurs. Loan officers could develop a "buddy system" whereby the loan officer who covers an office introduces a fellow loan officer as his replacement in case of sickness or absence. If a loan officer leaves, the "buddy" is already known and can fill in.
- It's very important to keep the office covered! Either the SMC branch manager or his/her best loan officers should take care of the affected office until a replacement can be found.
- The Coldwell Banker branch manager should help recruit a new loan officer.
- Build agent loyalty in SMC, not just the loan officer. When a loan officer leaves the company loyalty will still be intact. Agents must be sold on Sears Mortgage.
- Have the new loan officer meet with agents right away and take over the existing cases.
- Inform agents who have transactions pending that their loans will still be handled promptly and correctly and who is going to handle them.
- The Coldwell Banker manager must "hold it together" and work hard to keep agents loyal to Sears Mortgage.
- An interactive group effort is needed from the SMC and Coldwell Banker branch managers, the "stand-in" loan officer and the processor.

# Appendix D

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

| | |
|---|---|
| COALITION TO RETAIN INDEPENDENT SERVICES IN SETTLEMENTS (CRISIS)<br><br>Plaintiff,<br><br>versus<br><br>HENRY CISNEROS (in his official capacity as Secretary, Department of Housing and Urban Development)<br><br>Defendant. | CA 92-2700 (CRR) |

**DECLARATION OF PROFESSOR WILLIAM N. ESKRIDGE, JR.**

I, William N. Eskridge, Jr., declare under penalty of perjury pursuant to Local Rule 106(g):

1. I am a Professor of Law at Georgetown University Law Center, where I have taught since 1987. I am a member of the bar of the District of Columbia. From 1982 to 1987, I was an Assistant Professor of Law at the University of Virginia School of Law. From 1979 to 1982, I was an attorney in private practice at Shea and Gardner. My curriculum vitae is attached to this Declaration as Exhibit 1. My areas of academic specialization are statutory interpretation by agencies and courts, civil and administrative procedure, and the regulation of financial transactions. Since 1980, I have developed a specific expertise in the regulatory issues relating to home sales and loan transactions. Among other things, I represented a national

homebuilder in an important litigation matter while at Shea & Gardner, have written a lengthy law review article analyzing and criticizing federal regulation of the integrated home sale and loan transaction[1] and testified as an expert before the Housing Subcommittee of the House Banking Committee.[2] My litigation and academic experience have focused on the Real Estate Settlement Procedures Act of 1974 ("RESPA"), codified as amended at 12 U.S.C. § 2601 *et seq.*, among other statutes. I am also the co-author of a casebook on legislation and statutory interpretation.[3]

2. I have been retained by CRISIS to provide expert opinion about policy issues in connection with the above-captioned litigation, with particular focus on HUD's new regulation allowing realty and other companies to pay employees bonuses and commissions for referring homebuyers to their affiliated settlement providers ("the employee bonus rule"). 24 C.F.R. § 3500.14(g)(2)(ii), reported in 57 Fed. Reg. 49600, 49612 (Nov. 2, 1992). The opinions expressed below reflect my understanding of the academic and empirical literature on the dynamics of the home sale and mortgage transaction and positions

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1 See, Eskridge, *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 Va. L. Rev. 1083-1218 (1984).

2 See Eskridge, "Call to ARMS: Protecting Consumers Who Enter into Adjustable Rate Mortgages," in *Adjustable Rate Mortgages (ARMS): Hearings Before the Subcommm. on Housing & Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 98th Cong., 2d Sess. 226-66 (1984).

3 See Eskridge & Frickey, Cases and Materials on Legislation: Statutes and the Creation of Public Policy (1988).

I have taken in publications during the 1980s (see sources cited in notes 1 and 2). The opinions also reflect my examination of the following materials: RESPA and its legislative history, including the 1983 amendment adding the controlled business provision in RESPA § 8(c) (4), Pub. L. No. 98-181, § 461(b), (c), Stat. 1231 (1983); HUD's first proposed regulation pertaining to controlled businesses, reported in 53 Fed. Reg. 17,424 (May 16, 1988), as well as its "leaked" proposed final rule, reported in *Real Estate Settlement Procedures Act: Hearings Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs,* 101st Cong., 2d Sess. 287-319 (1990), and another draft final rule which surfaced the following year; several hundred of the public comments on HUD's proposed regulation; HUD's final rule which went into effect on December 2, 1992; HUD's justifications for the employee bonus rule contained in the official commentary, reported at 57 Fed.Reg. 49,602 (Nov. 2, 1992); and HUD's Final Regulatory Impact Analysis, RESPA, 24 CFR Part 3500 (Regulation X), Docket No. 1265.

3. By way of introduction, I will first review some of the dynamics underlying RESPA and what my study teaches me it was intended to accomplish. I do that not to supplant the Court's reading of these source materials but rather for the purpose of providing a backdrop for my conclusions. After assessing the statutory framework, I will focus on the final Regulatory Impact Analysis ("Final RIA"), wherein HUD sets forth assumptions underlying the employee bonus rule. My conclusion, elaborated

below, is that the Final RIA is a significantly flawed analysis resting on empirically unsound assumptions and poorly-structured reasoning.

4. Enacted in 1974, RESPA addressed the issue of "reverse competition" in the home sale and loan transaction. Because homebuyers relied heavily upon intermediaries (e.g., real estate agents) for choosing lenders, title insurers, and other providers, those providers tended to compete for market shares by providing incentives (e.g., kickbacks and rebates) to the intermediaries. They tended to avoid engaging in price and service competition directly benefitting the consumer. It can be, and has been, argued that reverse discrimination is not necessarily bad for consumers, to the extent that kickbacks and rebates might lower intermediary charges to the homebuyer. Congress found that this potential benefit did not exist in the home settlement market, however:

> In a number of areas of the country, competitive forces in the conveyancing industry have led to the payment of referral fees, kickbacks, rebates and unearned commissions as inducements to those persons who are in a position to refer settlement business. * * *
>
> In all of these instances, the payment or thing of value furnished by the person to whom the settlement business is referred tends to increase the cost of settlement services without providing any benefits to the homebuyer. * * * [I]t is the intention of section 7 [current RESPA § 8] to prohibit such payments, kickbacks, rebates, or unearned commissions.

S. Rep. No. 93-866, 93d Cong., 2d Sess. (1974), reprinted in 1974 U.S. Code Cong. & Admin. News 6546, 6551. Section 8(a) of RESPA, 12 U.S.C. § 2607(a), provides that no "person" shall give or accept "any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."

5. In the 1970's, several national real estate brokerage firms established affiliated companies that could provide title insurance and other settlement services for homebuyers. These "controlled companies" raised an important interpretive issue: Since the brokerage firm is a "person" under RESPA § 3(5), 12 U.S.C. § 2602(5), its receipt of a dividend from its affiliated title company to which it referred business might be considered a "thing of value pursuant to any agreement or understanding" that the title business should be referred to the title company, in violation of § 8(a). In the early 1980's, Congress deliberated whether RESPA could tolerate the existence of controlled title companies, hearing evidence of both the possible efficiencies arising out of controlled businesses and the possibility of consumer abuse.[4] In 1983, Congress added a new § 8(c)(4) providing that RESPA § 8 shall not "be construed as prohibiting * * * controlled business arrangements so long as

[4] See, e.g. *Real Estate Settlement Procedures Act -- Controlled Business: Hearings Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 97th Cong., 1st Sess. (1981).

"(A) homebuyers receive disclosures of such arrangements, (B) homebuyers are not required to use the controlled business services, and "(C) the only thing of value that is received from the arrangement, other than the payments permitted under [§ 8(c)], is a return on the ownership interest or franchise relationship." 12 U.S.C. § 2607(c)(4).

6. The 1983 amendment allows a realty company or lender to set up an affiliated title or settlement company and to refer business to that controlled company, so long as it meets the foregoing requirements, including § 8(c)(4)(C)'s requirement that the affiliated company provide only a return on investment. Nothing in the 1983 amendment otherwise retreats from § 8(a)'s mandate that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value" pursuant to an "agreement or understanding" for referring real estate settlement business.[5] Yet HUD's employee bonus rule now allows a "person" (an employee, sales agent, loan officer or sales manager) to "accept" a "thing of value" (a bonus or commission) pursuant to an "agreement or understanding" for referring settlement business to the firm's affiliated provider. As a student of statutory construction, I believe that this rule on its face is inconsistent with § 8(a)'s plain meaning.[6]

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[5] Congress' intent was that the 1983 amendment was "not intended to change current law which prohibits the payment of unearned fees, kickbacks, or other things of value for referrals." H.R. Rep. No. 98-123, 98th Cong., 1st Sess. 75-79 (1983).

[6] HUD misses the point of § 8 when it says that "§ 8(c) (4) does not authorize this type of prohibition on employee compensation." 57 Fed. Reg. at 49,602. As I read the statute, a prohibition on employee bonuses or commissions is based on the plain meaning of § 8(a).

7. Moreover, HUD's employee bonus rule is not, in my opinion, consistent with RESPA's overriding purpose, which is to seek "the *elimination* of kickbacks or referral fees that tend to increase unnecessarily that costs of certain settlement services." RESPA § 2(b)(2), 12 U.S.C. § 2601(b)(2) [emphasis added]. This policy point reinforces the prior conclusion that I draw from § 8(a)'s plain meaning. The remainder of this Declaration addresses this basic policy issue, analyzing whether HUD's Regulatory Impact Analysis is consistent with empirical experience.

8. HUD's Final RIA (at p. 15) states that the potential advantage of affiliated settlement companies is than they might deliver an array of services more cheaply and with less paperwork than non-integrated companies. The potential drawback is that the affiliated company might be able to draw upon a captive audience (the referring company's homebuying customers) that would not shop around and, hence, would be willing to pay higher-than-market prices. HUD poses the resulting policy issue as follows:

> The mitigating force against market power of the affiliated companies lies ultimately in competition, both among the affiliated companies and between the affiliated vs. non-affiliated companies. *This competition will occur only if homebuyers will shop.* Thus, whether the integrated companies may hurt rather than help consumers turns on whether integrated companies can effectively discourage consumers from looking elsewhere for a better deal.

Final RIA at p. 16 (emphasis added). Having framed the issue in this way, the rest of HUD's analysis ignores the documented experience of referral incentives in the last 20 years, including the experience that directly led to the enactment of RESPA. I will now review those points.

9. HUD's Final RIA at p. 16 says: "The companies that already operate affiliated settlement service providers claim that they can reduce costs of a settlement by several hundred dollars," because of administrative savings and lower marketing costs. I did not find any material documentation for this claim in the Final RIA or the public record. To my mind, undocumented statements by the very companies that stand to profit from HUD's controlled companies rules should not be accepted blindly without substantial support in the record.

10. HUD's Final RIA at p. 16 also says: "Even if savings are half this amount ($150 per transaction), the potential benefits of the new rule could be large." HUD then asserts: "Now 55% of transactions involve affiliated services," another figure HUD seemingly accepts upon the say-so of interested parties [see Final RIA at p. 8]. Accordingly, "[i]f all these transactions could result in net savings of $150 per transaction but prior to the new rule only half of these transactions did not involve cost savings because affiliated firms were inhibited by lack of guidance on this issue, then the benefits would be $148.5 million annually * * *." Final RIA at p. 17. The suggestion that affiliated firms "were inhibited by lack of guidance" seems overstated. The 1983 amendment authorizing controlled businesses

stated that realty and lending firms could refer title insurance and other settlement business to affiliated companies. The plain language of the statute provided plenty of "guidance" to affiliated companies, beginning in 1983. Therefore it is not surprising that according to HUD (Final RIA at p. 8), none of the top seven realty companies even waited for HUD to issue regulations confirming the 1983 amendment's effect. What was not clearly allowed by the 1983 amendment, what was also absent from the 1988 proposed regulation and the draft "final" regulations, and what I believe is contrary to § 8(a), is the rule of § 3500.14(g)(2)(ii), permitting Realtors or lending firms to give their employees commissions, bonuses, and other economic incentives to refer business to their affiliated companies (see Final RIA at p. 15).

11. Even if § 8(c)(4)'s authorization of referrals to affiliated companies yielded social benefits of $148.5 million (a figure I question below), HUD has given no reason to believe that § 3500.14(g)(2)(ii)'s employee bonus rule contributes anything to that social benefit. If affiliated companies offer cost savings and convenient one-stop shopping to homebuyers, is there any consumer-protective reason to allow realty and other companies to pay bonuses and commissions to their own employees for referrals? Shouldn't the "good deal" sell itself? To my thinking, there is no consumer-protective reason for allowing employee bonuses, but there is an obvious interest group reason -- to make sure that employees or sales managers or real estate agents or loan officers steer consumers to the affiliated company, whether they

offer consumers any benefits or not. In short, I do not believe that any of HUD's projected $148.5 million social benefit can be attributed to the employee bonus rule; if anything, the rule will yield a net social loss, and perhaps a substantial one.

12. HUD admits that the claimed benefits of its controlled business rule might be swallowed up by higher costs that affiliated companies might charge if they perceive consumers are not aware of current market prices, i.e., if consumers do not "shop around" (Final RIA at p. 17). This, too, is a considerable understatement. As a matter of economic logic, if homebuyers do not shop for title insurance and other settlement charges, there is little or no reason for companies to pass on to consumers any of the efficiencies HUD believes might arise out of the affiliated relationship. To the contrary, there is substantial reason to expect the affiliated companies to charge higher-than-market prices to at least some homebuyers. Moreover, HUD's newly-minted employee bonus rule offers a strong temptation for the most influential parties to the transaction (e.g., real estate agents and/or loan officers) to steer prospective homebuyers to their affiliated companies and thereby to discourage those homebuyers from shopping around. Ironically, therefore, the employee bonus rule not only threatens the goal of RESPA § 8(a) (the prohibition of kickbacks), but also of RESPA § 8(c)(4) (allowing referrals to controlled companies because they might offer lower prices to homebuyers).

13. My objections are not those of a casual observer. As an occasional homebuyer (I've owned two in my life), a former

representative of home sellers, and a published student of the regulatory process, I have read extensively in the literature on homebuyer behavior. See Eskridge, *One Hundred Years*, supra note 1, at pp. 1112-23. From the 1950's onward, social scientists have found it "surprising how lethargic and casual" most homebuyers are in searching for the best price for a home and an associated loan.[7] There is a general consensus that many homebuyers are intimidated by the complexities of the homebuying process, and the consequent stress frequently induces homebuyers to shorten the process and to slough off some of the decisions completely. Because the focus of the process is choosing a particular house, homebuyers are particularly likely to be lazy shoppers for financial services, including the home loan itself; because title insurance and other settlement services represent a small portion of the overall price and become most relevant only at the end of the homebuying process (when many consumers just want to get it over with and feel time-pressured), homebuyers are most likely to avoid any kind of shopping for those services. Peat Marwick's 1980 report to HUD on RESPA did the most thorough empirical study of this phenomenon of which I am aware. The report found that two-thirds of the homebuyers sampled did no shopping at all for a lender and that over 80% did no shopping at

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[7] Norris, *Processes and Objectives of Home Purchasing in the New London Area*, in 1 Consumer Behavior: The Dynamics of Consumer Reaction 25 (L. Clark ed. 1954). For more recent studies confirming this insight, see J. Arndt, Consumer Search Behavior: An Exploratory Study of Decision Processes Among Newly Married Home-Buyers (1972); FTC Los Angeles Regional Office, The Residential Real Estate Brokerage Industry (1983); Hempel, *Search Behavior and Information Utilization in the Home Buying Process*, in Marketing Involvement in Society and the Economy 241 (P. McDonald ed. 1969).

all for any provider of closing services.[8] And Peat Marwick found that only 11% of the interviewed homebuyers spoke to more than one title company.[9] Excerpts from the Peat Marwick study are attached to this affidavit as Exhibit 2.

14. If the homebuyer is not shopping for settlement providers, how is she or he choosing? The theoretical literature suggests that shoppers tend to shift responsibility for hard and/or less important decisions to someone else who has expertise. This is precisely what has been found to occur in the home sale and loan transaction. The Peat Marwick study found that most homebuyers who did not shop for a mortgage relied on the recommendation of the real estate agent or homebuilder,[10] and that 65% of the homebuyers surveyed simply chose the title insurer recommended by the real estate agent or the lender.[11] These "experts" (the agent or lender) of course might have an inherent bias toward steering the homebuyer to a particular company, especially if that company is affiliated with the agent's brokerage company or the loan officer's bank. This is a risk inherent in controlled business situations. But the risk becomes an all-but-certain occurrence when the referring employee

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8 2 Peat, Marwick, Mitchell & Co., Real Estate Closing Costs: RESPA § 14a at XIV.7 (1980).

9 Id. at XII.8. Peat Marwick further reported that most homebuyers believe that title insurance services and prices are pretty much uniform, a belief that is incorrect for most markets. Id. at XII.9.

10 Id. at X.31

11 Id. at V.24 (49% shift responsibility to agent, and 16% to lender; another 17% shift responsibility to an attorney).

or officer receives bonuses or commissions only if he or she refers the homebuyer to an affiliated company. In that event, the employee's or officer's income depends in some part upon such referrals.

15. The foregoing analysis turns HUD's Regulatory Impact Analysis on its head: Any "potential" consumer benefit from allowing referrals to controlled businesses is usually going to be negated by consumers' disinclination to shop, because the failure to shop creates a captive market willing to pay higher-than-market prices. The only effective protection for the homebuyer is the real estate agent's or loan officer's candor. That candor is severely and needlessly tested by HUD's new rule that permits employers to tie their employees' income to pushing customers to the affiliated entities. The result is not only to negate the potential savings from the controlled business, but to create an overall social cost: Consumers will probably pay more -- perhaps much more -- for settlement services.

16. My view on what likely will occur is not just a theoretical concern. Study after study has shown that when real estate professionals have incentives to refer settlement business to companies controlled by their employers, they will do so, and consumers will pay higher prices. Administrative proceedings in California in the 1970s found that the escrow company owned and controlled by Coldwell Banker charged rates 50%

higher than those competitors.[12] In the mid-1970s, the Department of Justice's Antitrust Division conducted a study of title companies affiliated with realty companies and concluded that controlled companies charged higher prices than other companies.[13] The Peat Marwick study in 1980 found that "it is simply unrealistic to assume that homebuyers will develop the knowledge or expertise necessary to ignore a broker's referral," that the existence of this captive market only invites higher prices, and that the Coldwell Banker phenomenon is the rule rather than the exception.[14] The same phenomenon was suggested in a 1987 report to the Wisconsin Commissioner of Insurance.[15]

17. There should be nothing surprising about the conclusions that homebuyers do not shop for settlement services; homebuyers defer to the recommendations of agents, employees and loan officers; and when those recommendations are skewed by referral fees, homebuyers are systematically referred to

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[12] See State of California, Dept. of Insurance, Findings of Fact etc., *In re Guardian Title Co.*, File NLic. L-67, UTC LA-70 (Oct. 27, 1976), rev'd, 2 Civ. No. 55067 (Super. Ct.), rev'd and recommendation reinstated, 102 Cal. App. 3d 381, 162 Cal. Rptr. 487, 491-92 (1980).

[13] See *The Pricing and Marketing of Insurance*, A Report of the Department of Justice to the task Group on Antitrust Immunities (Jan 1977), reprinted in *1981 RESPA Hearings*, supra note 4, at 212-83.

[14] 2 Peat Marwick Study, *supra* note 8, at XII.55.

[15] See Cleasby, *Controlled Business Operation in the Title Insurance Industry*, in Report to the Commissioner of Insurance, State of Wisconsin (July 31, 1987). See Also Palomar, *Bank Control of Title Insurance Companies: Perils to the Public That Bank Regulators Have Ignored*, 44 Sw. L.J. 905, 932-33 (1990).

providers that charge higher-than-market prices. A HUD study 20 years ago made similar findings.[16] Specifically, in 1972, HUD found that the enormous price variation in settlement services was due in large part to the dearth of consumer shopping. These findings documented the main problem that Congress was trying to solve when it enacted RESPA in 1974. A key element in Congress' approach was the prohibition in § 8(a) against referral bonuses and commissions. Yet in 1992, HUD's new employee bonus rule offers to legalize the functional equivalent of the inefficient and inflationary referral system that gave rise to RESPA in the first place.

I declare that the foregoing is true. Executed at Washington, D.C. this 16th day of February 1993.

William N. Eskridge

William N. Eskridge, Jr.
Professor of Law

16 See U.S. Dept. of Housing & Urban Development and Veterans Admin., Mortgage Settlement Costs, reprinted in *Real Estate Settlement Costs, FHA Mortgage Foreclosures, Housing Abandonment, and Site Selection Policies: Hearings on H.R. 13337 Before the Subcomm. on Housing of the House Comm. on Banking and Currency*, 92nd Cong., 2d Sess. 735 (1972).

# Appendix E

NORTHERN VIRGINIA BOARD OF REALTORS® INC

Mailing Address P.O. Box 586 Merrifield, VA 22116
Offices located at 8411 Arlington Blvd. Fairfax, VA
(703) 560-7350

June 28, 1988

HUD Office of General Counsel
Rules Docket Clerk, Rm 10278
451 Seventh Street, N.W.
Washington, D.C. 20410

On behalf of the more than 10,000 members of the Northern Virginia Board of REALTORS (NVBR), the largest local real estate trade association in the country, I would like to express serious concern over the proposed change to the rule governing referral fees as outlined in Section 8 of the Real Estate Settlement Procedures Act (RESPA).

NVBR is opposed to its members accepting any type of referral fee, service fee, financial inducement or other thing of value from mortgage lenders or brokers in conjunction with the placing of, or securing of, a residential loan.

As the proposed rule change currently reads, a Lender would be allowed to make payments to a mortgage broker as long as the payments are fully disclosed and a service is rendered. We strongly believe that this kind of arrangement runs counter to the original intent and "spirit of RESPA". Furthermore, it would establish an unhealthy precedent, inevitably creating situations ripe for conflicts of interest between real estate agents and their customers. We strongly urge you to reconsider.

Thank you for the opportunity to comment on the proposed changes.

Sincerely,

Edward E. Pagett, CRB, CRS, GRI
President

# Appendix F

niguel escrow
30110 crown valley pkwy • suite 107
laguna niguel, california 92677
714/495-4591 714/831-8066

# Facsimile Transmittal

**Date:** 3/4/93

**To:** HOWARD BIRMIEL

**Attn:**

**From:** DEBBI FABER

**Re:** KICKBACKS

**Number of pages being transmitted after this cover:** too manyto count!

**Special Instructions:** Here are some things that I have been collecting with permission of the authors to fax to you as well as Freedom Realtors newsletter to their agents. Freedom is just the latest company in our area to do this! This has been happening here in South orange County for several years, but now with the new regs, this makes it OK and these Brokers are now scrambling to do the 1% ownership thing!

**Our FAX number is (714) 249-8985**

TO WHOM IT MAY CONCERN:

My name is Debbi Faber and I am 39 years old. I am a single parent of a 23 year old son. My escrow career began in January 1972 when I was hired as a receptionist/girl Friday for a branch office of a large escrow company in Thousand Oaks, California. I was soon transferred to Orange County and rose through the ranks to be an escrow officer. After 7 years, I left the company for personal reasons (i.e. divorce, residence burnt down, etc.) and after much thought, I decided to open my own escrow company in South Orange County where I did not have a following.

On March 1, 1979, I opened Niguel Escrow. I have had 15 good and some not so good years, but I have been able to weather the down turns in the real estate market. I have earned the professional designation of "Certified Senior Escrow Officer" as awarded by the California Escrow Association as well as many awards from the local boards of realtors for my continued support of their programs. I have given many educational seminars and trained numerous escrow trainees. I am the past president of the Escrow Institute of California and have been active in many efforts to stop this growing trend in our industry, all to no avail. Is anyone listening? Does anyone care? Most times I think not!

My business has been doing poorly for a year or so. The refinance honeymoon helped to prolong the inevitable and the economic climate has helped to accelerate the inevitable! The real reason my business has been suffering more in the last year than before is due to the fact that my client base has eroded over the last few years because most of the agents here in this area have gone to work for brokers who either own or have a tie-in of sorts with a escrow company. If the agent has their closing done by one of these companies, the agent recieves incentive. There are many different forms, but some of them are that their E & O insurance is paid, their desk fees are waived, their commission is a higher percentage or they can get a portion of their commission advanced. These same brokers have relationships with title companies, lenders, termite companies, home protection companies, etc. and the list goes on and on. Most of these brokers have a "closed door" policy which translates into the rest of us escrow, title, lender, etc., not being permitted into their offices to introduce ourselves and our companies. Is this not restraint of fair trade???? These brokers were in heaven when the new RESPA regs came out so what they have been doing all along was suddenly blessed. Wasn't RESPA originally to help protect the consumer? I do understand the economics of why the agents and brokers are doing what they are doing, but I am prohibited by law from doing the same thing. My regulators call it "KICKBACK"!.

In Southern California we have dealt with Coldwell Banker and Tarbell Realtors for many years having this arrangement, but I now have only TWO companies left in my area that do not have an escrow tie-in. TWO! The Brokers are now telling me that they are in the process of becoming 1% owners and that our industry is changing and I better get with the times!

I refuse to work for a company that has escrow business because someone is paid to bring the escrow to them. What happended to the fiduciary relationship that is so important to a real estate closing??

Do to the continued growing trend of Brokers paying their agents "incentives" to take their escrows to certain companies, I refuse to borrow money to try and "wait out" the economy because I do not know how I will pay it back. I have no clients! I have chosen to close Niguel Escrow on March 31, 1993 after 15 successful years here in the community.

I have several other peers who are literally just holding on month by month who also refuse to borrow money to hold on. One of my friends is 50 years old and is isn't up for starting a new career! My closest competitor has closed 2 of her offices. We are an endangered species!

What about free enterprise??

# Appendix G

The material contained in Appendix G has been retained in Committee files, and may be viewed there upon request.

U.S. Department of Housing and Urban Development
Office of Public Affairs

Washington, D.C. 20410

# News Release

HUD No. 93-27
Michael Zerega (202) 708-0685
Bob Nipp (202) 708-0685

FOR RELEASE
Monday
May 17, 1993

## HUD PRESSES CONSUMER PROTECTION IN $700,000 COLDWELL BANKER SETTLEMENT

HUD Secretary Henry G. Cisneros signed a settlement agreement involving Coldwell Banker Residential Real Estate that will protect American homeowners and home buyers involved in real estate transactions.

"In something as complicated as a home sale closing, it's important for consumers to know that HUD will enforce the law that protects them in the settlement process," Cisneros said. "Kickbacks and unearned fees are against the law."

In the settlement agreement, HUD alleged various Coldwell Banker affiliated companies engaged in practices to steer consumers to other affiliated companies and that they got kickbacks for the referral of business, and they also received unearned fees. HUD alleged that these practices violate the Real Estate Settlement Procedures Act (RESPA). Coldwell Banker and its affiliates deny these allegations but agreed to settle.

The settlement directly involves activities of the company and its affiliates in New Jersey and Minnesota. Terms of the settlement include payments of over $700,000 with half-a-million dollars designated for consumer restitution and education programs in New Jersey and Minnesota.

Under the agreement, consumers in New Jersey who were referred by BorrowersChoice (an affiliated mortgage broker and computer loan origination operator) to Coldwell's affiliate, Sears Mortgage Corporation, in approximately 783 transactions between October 29, 1992 and April 17, 1993, will receive refunds of $500. HUD and the State of Minnesota will each receive payments of $100,000. In addition, consumers nationwide will receive greater disclosure of the controlled business arrangement among Coldwell affiliated companies.

Under the settlement Coldwell Banker and its affiliates will disclose to consumers in the future whenever the companies they refer customers to are either direct or indirect affiliates and that it "is in the financial interest of these companies or their parent companies to refer business to each other."

Coldwell Banker agreed to a number of actions as a part of the settlement:

-- Payments for transactions covered by RESPA must bear a reasonable relationship to the value of services rendered or goods or facilities provided.

-more

-- Coldwell Banker and its affiliates will provide clearer identification of consumer and lender fees on listing agreements, worksheets, HUD-1 forms, and other fee disclosure forms.

-- Coldwell Banker and its affiliates will not require home sellers or buyers to use one of their controlled businesses.

-- Coldwell Banker will distribute a memorandum nationwide to employees and sales agents informing them that there will be no quotas for referrals to affiliates and no penalty for recommending an unaffiliated settlement service provider.

RESPA was first passed in 1974 and prohibits the payment or receipt of referral fees and provides for disclosure of the relationship between, and the costs charged by providers of real estate settlement services.

The Minnesota investigation was conducted jointly with the Minnesota Attorney General's office.

Copies of more detailed information and the agreement may be obtained from HUD c/o David Williamson, RESPA Staff Director, at 202-708-4560.

$700,000 RESPA SETTLEMENT REACHED BETWEEN HUD AND COLDWELL BANKER AND ITS AFFILIATED COMPANIES

The Department of Housing and Urban Development today announced a major settlement agreement involving Coldwell Banker Residential Real Estate ("Coldwell Banker") and various affiliated companies. The settlement culminates HUD's investigations into alleged violations of the Real Estate Settlement Procedures Act ("RESPA") in Minnesota and New Jersey.

Terms of the settlement include payments of over $700,000 with half-a-million dollars designated for consumer restitution and education programs in New Jersey and Minnesota. Under the agreement consumers in New Jersey who were referred to Coldwell's affiliate, Sears Mortgage Corporation, in approximately 783 transactions between October 29, 1992 and April 17, 1993, will receive refunds of $500. HUD and the State of Minnesota will each receive additional payments of $100,000. In addition, consumers nationwide will receive greater disclosure of the controlled business arrangement between Coldwell affiliated companies.

The Minnesota investigation was conducted jointly with the Minnesota Attorney General's office. In Minnesota, HUD and the Attorney General investigated practices in which home sellers

executing a listing agreement with Coldwell Banker agreed to pay a $195 fee for administrative and closing services. Coldwell Banker then entered agreements with closing agents to become "approved closers." Under the agreements, the closers retained $100 and Coldwell Banker received $95 to "defray administrative costs."

HUD alleged that the $95 charge was for services normally covered by the real estate commission and was an unearned fee not commensurate with the value of services performed., Further, HUD claimed that customers were not adequately informed of the exact amount Coldwell Banker received, and settlement agents considered the $95 fee to be a payment for the referral of business.

The Department also alleged that Coldwell Banker and Sears Mortgage referred title business to an affiliate, Guardian Title Services, Inc., through unaffiliated underwriters, without proper disclosure to consumers of their relationship to Guardian and of the arrangement with the underwriters. In addition, HUD charged that under agreements with the underwriters, Guardian received both a flat fee for services and 75% of the title insurance premium.

In New Jersey, sales agents and employees of Coldwell Banker

Schlott Realtors referred home buyers to their affiliated company, BorrowersChoice, located in their offices, for assistance in selecting a mortgage loan. BorrowersChoice held itself out as providing information on loan products of various lenders, including Sears Mortgage, on their computer loan origination ("CLO") system. BorrowersChoice received compensation from loan applicants and from lenders. HUD initiated the New Jersey investigation after receiving complaints that managers in the Coldwell Banker offices were threatening the employees of BorrowersChoice that they would be fired unless they steered a certain quota of business to Sears Mortgage. The Department alleged that consumers were referred to Sears without proper disclosure of the relationship between these affiliated companies. These practices may have resulted in certain consumers paying higher costs.

The New Jersey investigation also involved allegations that lenders had to make payments to gain access to the BorrowersChoice CLO system that did not reflect the cost of the services provided (the CLO system consisted primarily of faxing rate sheets).

In the settlement agreement, HUD alleged that the practices of the various Coldwell Banker affiliated companies violated RESPA's provisions which prohibit kickbacks for referral of settlement business and retaining a portion of a charge other than for services performed. The Department further alleged that the companies did not meet the statutory exemption requiring disclosure of controlled business arrangements. Coldwell Banker and its affiliates deny these allegations.

As part of the settlement, the affiliated companies agreed to disclose to consumers in the future that the companies were either direct or indirect Sears subsidiaries, and that it "is in the financial interest of these companies or their parent companies to refer business to each other."

The settlement agreement also provides:

o Coldwell Banker and affiliates will not set quotas for referrals by sales agents or the employees of the CLO to affiliated companies. They will not penalize such persons for referring consumers to unaffiliated settlement service providers.

o Coldwell Banker will distribute a memorandum nationwide to employees and sales agents (to be included in training materials) concerning the policy of no quotas for referrals to affiliates and no penalty for recommending another company.

o Coldwell Banker will not require home sellers or buyers to use a controlled business.

o Within 90 days, Coldwell Banker and affiliates will revise their Controlled Business Arrangement (CBA) Disclosure Forms nationwide to provide: clearer description of consumer information regarding non-required use, ownership and financial interests of affiliates, and charges of a referred entity. Coldwell Banker Schlott Realtors and BorrowersChoice in New Jersey will change their forms within 30 days.

o CBA Disclosure forms will be provided at the time of referral, or a reasonable period before the referral. This includes referrals to an unaffiliated company which will result in referral to an affiliated company.

o If BorrowersChoice operates a multi-lender CLO system, it will either be lender-neutral or it will provide a clear disclosure that particular lenders will be promoted.

o Lender payments to BorrowersChoice will not be for referrals of settlement business. Payments for RESPA covered transactions must bear a reasonable relationship to the value of services rendered or goods or facilities provided.

o Coldwell Banker and its affiliates will provide clearer identification of consumer and lender fees on listing agreements, worksheets, HUD-1 forms, and CLO Fee Disclosure forms.

o Guardian will perform core title services to receive title agent compensation.

o Coldwell Banker and its affiliates will notify all employees, sales agents and franchisees nationwide of the terms of the agreement.

o Coldwell Banker or its affiliates will pay:

$ 391,000 in refunds of $500 per transaction in 783 transactions (or fewer, depending on loans actually closed) to borrowers in New Jersey.

$ 15,000 to the New Jersey Division of Consumer Affairs for consumer education in New Jersey.

$ 95,284 for consumer education purposes in Minnesota.

$ 100,000 to the State of Minnesota.

$ 100,000 to HUD.

Total refunds and payments: $701,284.

o The Department agreed to terminate all pending investigations of Coldwell Banker and it affiliates and not to conduct any new RESPA investigation of them for 90 days so Coldwell Banker can change practices nationwide to conform with the agreement.

o The agreement is binding upon Coldwell Banker and its affiliate's successors and assigns.

The parties to the Agreement with HUD are Coldwell, Banker & Co. (the parent of Coldwell Banker Residential Holding Company, BorrowersChoice Corporation and Sears Mortgage Corporation); Coldwell Banker Residential Holding Company (the parent of Guardian Title Services, Inc., and Coldwell Banker Residential Real Estate); Coldwell Banker Residential Real Estate (the parent company of Coldwell Banker Real Estate Services, Inc.); Coldwell Banker Real Estate Services, Inc., doing business in New Jersey

as Coldwell Banker Schlott Realtors; Guardian Title Services, Inc.; and BorrowersChoice Corporation; together with their affiliates, subsidiaries, employees, agents, successors and assigns.

This settlement is the first major agreement since the RESPA regulations were revised on November 2, 1992. The settlement affirms HUD Secretary Henry Cisneros's commitment to enforce RESPA and to protect consumers and lawful competitors in the real estate industry.

***Executive Summary – Oral Statement***

**Testimony**

**of**

**Howard A. Birmiel**

**on behalf of**

# CRISIS*

**on**

# Anti-Competitive Impacts of Referral Fees/Kickbacks & "Controlled Business Arrangements"

**in**
**Residential Real Estate Settlements**

**Submitted at the**

**House Small Business Committee's**
**Hearing on HUD's RESPA Regulations**

***July 1, 1993***

* "The Coalition to Retain Independent Services in Settlements"

**Statement**
**of**
**Howard A. Birmiel**
**on behalf of**

**CRISIS**

**before**
**House Small Business Committee**

*July 1, 1993*

Mr. Chairman and members of the Committee, my name is Howard Birmiel, and I am a small businessman from northern Virginia. I own a title insurance agency and employ eight people. Today, I am testifying on behalf of CRISIS, the Coalition to Retain Independent Services in Settlements. Accompanying me for the purpose of responding to questions from the Committee are Mr. Joel Holstad and Mr. John Farmer, CRISIS members who are affiliated with the Independent Land Title Association of Minnesota.

CRISIS represents independent small businesses who provide the various ancillary services needed in connection with residential real estate settlements.[1] These services include: title insurance; homeowners' insurance; escrow services; mortgage brokerage; mortgage lending; surveys; appraisals; and the preparation and filing of legal documents. Thousands of these small businesses actively compete to provide such services throughout the nation, and in many areas like metropolitan Washington, they do the overwhelming majority of such settlement work.

We deeply appreciate your holding this hearing which will highlight both: (1) the anti-competitive effects of the kickback fees that are sanctioned by HUD's controversial RESPA rules issued last November by the prior Administration; and (2) the related problems that arise because of inadequate legislative safeguards in the "controlled business" provisions in the RESPA statute.

As I will explain, if the Clinton Administration and Congress fail to promptly revise the regulations and add new statutory protections then thousands of small independent businesses that now provide settlement services will be severely injured and many will be forced out of business. Consumers also will end up paying millions of dollars in unnecessary settlement charges.

## I. <u>How The "Controlled Business" Kickback Process</u>[2]

**Referrals Guide Consumer Purchases** - It has long been established that most consumers rely on the referral recommendations of real estate professionals----typically, their real estate agent or

[1] CRISIS is joined in its efforts in opposing these RESPA provisions by numerous other organizations, including: National Association of Mortgage Brokers ("NAMB"); Consumer Federation of America; Independent Insurance Agents of America ("IIAA"); American Land Title Association ("ALTA"); California Escrow Institute ("CEI"); Savings and Community Bankers Association ("SCBA"); Mortgage Bankers Association ("MBA"); Florida Association of Independent Title Agents; Independent Land Title Association of Minnesota; and H.F. Ahmanson Company.

[2] See attached chart.

mortgage lender----to select the firms from which they purchase title insurance and the various other settlement services needed when buying their homes.[3]

**HUD's Rules Sanction Kickbacks RESPA Sought To Prohibit** - Even though RESPA was passed expressly to prohibit referral fees and other types of kickbacks, HUD's new RESPA rules specifically allow large, diversified real estate firms or mortgage lenders to pay their employees referral fees for steering consumers to purchase settlement services from their affiliates.

**Referral Fees Enable Controlled Businesses To Control The Market** - These "one stop shopping" schemes are aptly called "controlled business arrangements" because they are very effective in controlling where the consumer buys settlement services. HUD's RESPA rules allow these larger controlled business organizations to deny small independent settlement providers any meaningful opportunity to compete for the consumer's business on the basis of the prices and services being offered. Referrals ultimately will be based on the referral fee instead of an unbiased judgment of who will give the consumer the best price and service.

**Self-Referral Fees Are Anti-Competitive & Hurt Consumers** - This "one-way steering" is anti-competitive. Independent small firms will be cut out of a major segment of the market. Many of us will be driven out of business. Moreover, consumers will end up paying millions of dollars in unnecessary settlement charges.

**Inherent Conflicts Engender Abuses** - Common sense tells us----and experience has shown---- that settlement work referrals are often not likely to be made in the consumer's best interest when the real estate professional is allowed to get referral fees and other kickbacks for making such referrals. The real estate agent or lender who makes the referral has a clear inherent conflict of interest if they get paid for steering the consumer to a particular provider. For example, in comments filed during HUD's rulemaking on these RESPA regulations, the Northern Virginia Board of REALTORS (NVBR), which is the largest local real estate trade association in the country with more than 10,000 members, stated:

> *NVBR is opposed to its members accepting any type of referral fee, service fee, financial inducement or other thing of value from mortgage lenders or brokers in connection with the placing of, or securing of, a residential loan. . . . We strongly believe that this kind of arrangement runs counter to the original intent and "spirit of RESPA." Furthermore, it would establish an unhealthy precedent, inevitably creating situations ripe for conflicts of interest between real estate agents and their customers.*

## II. How HUD's Controlled Business Rules Turned RESPA On Its Head

**RESPA's Prohibition On Referral Fees & Other Kickbacks** - After exposes in the early 1970's revealed that abusive settlement charges and conflicts of interest were rampant, Congress passed RESPA in 1974 to prohibit such practices and "something for nothing" charges. Section 8(a) of RESPA provides:

> *No person shall give and no person shall accept any fee, kickback or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to*

[3] The attached excerpt from the Consumer Federation's amicus brief in our pending litigation against these HUD rules explains how, as Congress has previously found, consumers hire settlement service providers based on the recommendations of real estate agents and mortgage lenders. It also points out that allowing firms to pay referral fees to employees for steering business to controlled providers is anti-competitive and harmful to consumers' interests.

*or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.*

**Controlled Business Limitations In The 1983 RESPA Amendments** - In 1983, Congress passed an amendment to clarify that RESPA did not prohibit real estate brokerage companies from having affiliated firms (e.g., title insurance agencies) that provided settlement services. However, Congress clearly recognized that abuses could readily occur if strict limitations were not imposed on such so-called "controlled business arrangements." RESPA Section 8(c)(4) stated controlled business arrangements were allowed only so long as:

*. . . the only thing of value that is received from the [controlled] arrangement . . . is a return on the ownership interest or franchise relationship.*

Ownership interest was narrowly defined as a "dividend" or "partnership distribution," and payments based on the mere fact or volume of referrals are prohibited under this provision. Congress' intent to continue Section 8's prohibition was expressed in the House Banking Committee's 1983 report:

*[T]his provision is not intended to change current law which prohibits the payment of unearned fees, kickbacks, or other things of value for referrals.*

**HUD's Politically Based Attempt To Rewrite RESPA** - For nearly 10 years, HUD failed to issue regulations implementing the 1983 amendments. When these rules were finally issued in November of 1992 by the outgoing Administration, HUD made a dramatic last-minute reversal and allowed controlled businesses to pay employees referral fees for steering business to affiliated firms, even though HUD's own legal interpretation was that paying referral fees to controlled businesses' employees was illegal! This position was espoused in a letter from HUD's Deputy Secretary to OMB in late August of 1992[4]:

*[T]he General Counsel has determined that employers may not compensate employees who refer business to affiliated companies, because such referrals are prohibited under RESPA sections 8(a) and 8(c)(2), even where the provisions of the "safe harbor" in section 8(c)(4) have been met.*

My full written statement, which is being filed for the hearing record, and our pleadings in the lawsuit CRISIS has filed to overturn these regulations, provide extensive documentation regarding how the rulemaking process was subverted. The new final rule purports----contrary to the earlier drafts of these rules, and clearly contrary to RESPA----to allow controlled business firms to pay referral fees as compensation to their employees for referring settlement business to their captive affiliates.

**HUD's Tortured Reasoning** - In essence, HUD justified its new RESPA rule on the following strained reasoning: (1) Section 8's prohibition on kickbacks requires two separate parties; (2) thus, if a controlled business firm pays a referral fee to a third party (e.g., a real estate agent from a non-affiliated company) for referring settlement work to its captive affiliate, this violates RESPA; but (3)

[4] See attached letter.

a company and its own employees are not separate parties, so paying kickbacks in controlled arrangements is not illegal.

Mr. Chairman, I ask you, how could Congress have possibly intended such an absurd result?[5] CRISIS believes that you and other Committee members will agree with our position that Congress intended that no such referral fees be allowed, and we urge you to help us obtain regulatory and legislative relief.

## III. Reforms Must Be Adopted

My written statement details how many firms are already trying to exploit RESPA's weak points and HUD's new regulation to control the settlement business by using controlled business arrangements.[6] Small independent service providers can not possibly compete in such unfair circumstances where the work is steered away from them by paying fees for referrals to controlled providers. This rule will destroy the competitive market for settlement services and thousands of small independent businesses that now provide such services to consumers.

**Legislative Reforms Are Needed** - In closing, I want to emphasize that it will not be adequate to merely withdraw and reissue these flawed HUD regulations with a prohibition on referral fees. That would be a necessary and helpful step to prevent unfair competition and consumer abuses. However, HUD's issuance of these rules eight months ago, and the ensuing publicity alerted firms as to how easy it is to profit through controlled business arrangements. We have no doubt that such controlled businesses in many cases will provide a ready vehicle for covert circumvention of RESPA's prohibition on referral fees and other kickbacks. There are many undisclosed payments and economic benefits that can be paid to real estate agents and lenders to refer business to an affiliate. Policing such kickbacks will be extremely difficult, if not impossible, especially since HUD has only a very small enforcement staff. California and several other states like Minnesota experienced many of these problems well before HUD's controversial new regulations were issued.

Thus, CRISIS believes that the only effective way to protect against such controlled business abuses is to pass additional legislative safeguards. Congress should impose limitations on the amount of business that can be referred to a controlled affiliate and tougher penalties for violations of the anti-kickback provisions. In addition, HUD's RESPA enforcement staff, which is quite dedicated to preventing abuses, is quite small. Try as they might, this limited staff can not effectively handle the large number of cases that are arising. Congress should significantly increase the size and resources of this RESPA enforcement office.

* * * *

Thank you for hearing our concerns. I would be pleased to respond to your questions.

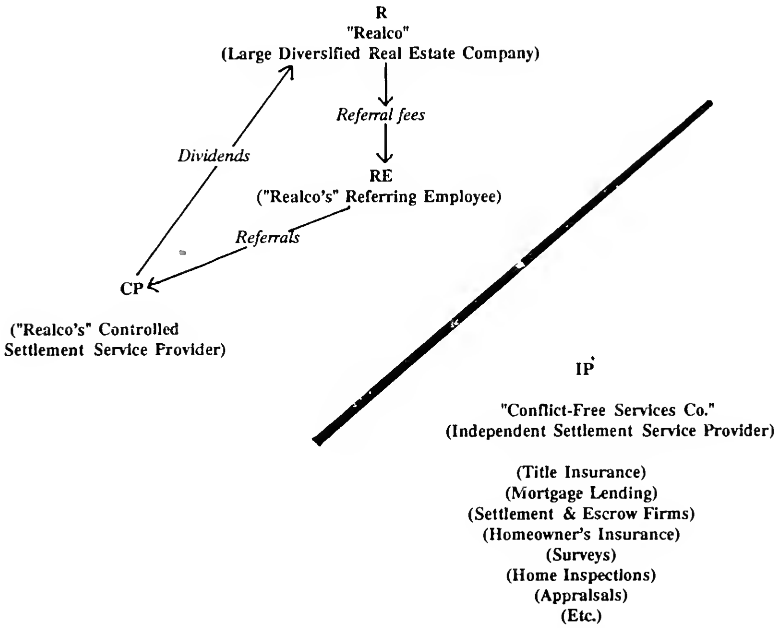
---

[5] As indicated by the attached letters, the House and Senate Banking Committees have already advised HUD of concerns regarding these RESPA rules. They have not yet, however, scheduled hearings or taken legislative action.

[6] Recently, after CRISIS filed suit, HUD announced--claiming a great consumer victory--the simultaneous filing and settlement of an administrative proceeding charging Coldwell Banker and its various affiliates with wholesale steering violations of RESPA in New Jersey and Minnesota. The case was settled by a "consent" order in which Coldwell Banker denied all allegations. Our general sense of the settlement market leads us to feel that there may well be some, if not a great degree of, truth, in HUD's attached May 17th news release which alleged that firms were "*engaged in practices to steer consumers to other affiliated companies and that they got kickbacks for the referral of business, and they also received unearned fees.*"

self-referrals within these so-called "controlled business arrangements" are allowed, referral fees can not be paid by independent providers to obtain settlement business. These new rules reverse HUD's position against such self-enrichment schemes. They are an administrative attempt to rewrite the RESPA statute and delete its safeguards against these types of unnecessary charges.

**The following illustration shows how this referral fee/kickback scheme works:**




"Realco" pays its employee referral fees/kickbacks whenever he or she refers settlement business to "Realco's" controlled provider. The increased profits generated by controlling the ancillary settlement work are then passed up as dividends to "Realco" which uses these profits to compensate for its paying kickbacks to employees. It makes no personal economic sense for "Realco's" employees to refer any business to small independent providers like "Conflict-Free Consumer Services Co." Therefore, "Realco's" employees will refer virtually all settlement work to "Realco's" controlled provider and the independent providers have no way to compete in this controlled business market.

The following excepts from the Consumer Federation's amicus brief in the pending litigation against HUD's new RESPA regulations clearly describe why and how consumer injuries will occur:

> *"The real injury consumers suffer when kickbacks and other kinds of financial inducements are allowed to influence the referral of the consumer's settlement business is not simply that such payments by themselves inflate the cost of settlement services. It is the fact that such payments fundamentally alter the nature of market competition to the detriment of consumers. Instead of having settlement service providers competing in ways that serve the consumer's interest, competition is channeled in directions that serve the personal financial interest of the real estate professionals who are in a position to influence the consumer's selection or to make that choice for him.*
>
> *The purchase of settlement services confronts consumers with problems that they do not face in most other areas where they have knowledge and ability to shop effectively on their own for the provider who offers the best combination of price, quality, and service. Most consumers buy a home only once or twice in their lives; they have little or no familiarity with the purchase of the kinds of services needed in connection with the real estate transaction; and they frequently do not have the time between the signing of the purchase contract and the closing to become knowledgeable shoppers for services that they may never again need.*
>
> *Given these factors, it is inevitable that consumers will look to and rely upon the recommendations or referrals of their real estate broker or the mortgage lender. These professionals have the knowledge and experience that the consumer lacks; these people are involved in real estate settlements all the time and are in a position to know the quality and value of the service providers in the market. Accordingly, in the overwhelming number of residential real estate transactions the selection of a title company or other settlement service professional is made on the basis of referrals from brokers, lenders and other real estate professionals.*
>
> *If the broker's or lender's recommendation cannot be influenced by a referral fee or other personal financial inducement to steer the business to a particular company, then referrals will be made on the basis of which provider can best serve the consumer's interest. Competition among settlement service providers -- who know that they have to compete for the referrals of these knowledgeable surrogate shoppers on the basis of the competitive merits of their products and services -- will thus be channeled in directions that serve the best interests of consumers.*
>
> *It is this kind of competitive environment that Congress sought to foster in enacting section 8. While the 1983 amendments determined that referrals to controlled business*

*affiliates were not violations of section 8 if certain prescribed conditions were met, Congress did not otherwise intend that the basic consumer-oriented thrust of section 8 was to be altered. But this is precisely what HUD's employer referral fee and CLO rules would do.*

*The employer referral fee rule encourages employees of brokerage firms and mortgage lenders to steer the consumer to the employer's controlled business affiliate even if other firms can provide better prices, quality or service. It is simply unrealistic to believe that allowing such payments will not determine the direction of referrals. Moreover, the controlled business affiliate does not have to compete on the merits for the recommendation of that employee when the affiliate knows that the employee will be receiving a direct financial incentive from his employer to steer business its way. As a consequence, consumers will not only end up having to pay for such fees, but the entire dynamics of competition among settlement service providers becomes altered to the detriment of consumers. Indeed, if controlled business arrangements continue to develop, and employer referral fees are permitted to be paid to ensure that consumers get steered to the broker's or lender's affiliate, there is a great danger that few if any consumers will be able to escape the one-way highway of financially-induced referrals to captive affiliates."*

Statement of

TERRY ROWLAND

Vice President and General Manager

PROSPERITY MORTGAGE CORPORATION

on behalf of the

REAL ESTATE SERVICES PROVIDERS COUNCIL (RESPRO)

Before the

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

on the

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

July 1, 1993

Good morning, Mr. Chairman and Members of the Committee. My name is Terry Rowland, and I am Vice President and General Manager of Prosperity Mortgage Corporation, a subsidiary of Long & Foster Cos., Inc. Our sister company, Long & Foster Real Estate, Inc. provides real estate brokerage services through 132 offices and 6300 agents in the states of Virginia, Maryland, Pennsylvania, West Virginia, Delaware, as well as Washington, D.C.

Today, I represent the Real Estate Services Providers Council, called RESPRO, of which Long & Foster Cos., Inc. is a member. Mr. Chairman and Members of the Committee, RESPRO welcomes the opportunity to testify on the Department of Housing and Urban Development's (HUD) final Real Estate Settlement Procedures Act (RESPA) regulation.

**BACKGROUND OF RESPRO**

RESPRO was formed in 1992 by diversified real estate services providers throughout the country-- known as "controlled business arrangements" under RESPA-- who decided to unite to support a federal and state regulatory environment that allows businesses to offer one-stop shopping for homebuyers.

Our membership is open to companies of all sizes offering a wide variety of settlement services for homebuyers. Attachment I to my testimony provides a list of RESPRO's members, which total twenty-two and are still growing. As you can see, our membership is open to real estate brokerage companies, mortgage companies, title companies and any other provider of "settlement services" as defined by HUD under RESPA. But no matter what size the RESPRO member-- and no matter what the services it offers-- we are united by one common bond: we strongly support a regulatory environment that increases consumer choice, enhances consumer service, increases competition and lowers costs by allowing companies to offer one-stop shopping for homebuyers in a cost-efficient manner through affiliations, joint ventures, and partnerships with companies offering related services. (See Attachment 2).

RESPRO believes that the current RESPA law and HUD's 1992 final RESPA regulation provide such a regulatory environment. Our testimony today will discuss (1) Marketplace changes since RESPA was enacted in 1974; (2) Consumer benefits from diversification into related services; (3) Problems associated with the pre-1992 regulatory environment for diversified companies; (4) Benefits from HUD's 1992 RESPA rule; and (5) Benefits from a diversified company's ability to compensate management for developing and implementing one-stop shopping programs for homebuyers.

## MARKETPLACE CHANGES SINCE RESPA WAS ENACTED IN 1974

As you know, Mr. Chairman, Congress enacted RESPA in 1974 for two purposes: (1) to provide consumers with better and more meaningful disclosure of real estate settlement service costs, and (2) to protect consumers against unnecessarily high settlement service costs. To accomplish the second purpose, RESPA restricted the ability of one settlement service provider to pay fees to another provider for a mere "referral" of business.

After RESPA was enacted in 1974, three fundamental changes in the real estate services marketplace have made it not only desirable but inevitable that real estate service providers establish financial relationships ("controlled business arrangements") with other settlement service providers in order to offer multiple products and services for homebuyers.

First, homebuyers' demands have significantly changed since RESPA was enacted. As you can see from Attachment 3, two-income households made up 38 percent of the population in 1974. By 1990, it was 47 percent; the number is expected to make up 52 percent of total households by 1995.

More two-income households means less time available to spend on the complex home purchase transaction. It means homebuyers want more convenience. They no longer have the time or the desire to go to a real estate broker for brokerage services, a mortgage broker or mortgage lender for a mortgage loan, a title company for title insurance, and so on down the line. Many homebuyers want the option to weigh the qualities of each real estate service provider with the convenience offered by the purchase of products and services from a single source.

A second major change in the marketplace has been the increasingly widespread use of advanced technology in home and business. The availability of computers, hotlines, FAX machines, and other technology enable real estate brokers, mortgage lenders, mortgage brokers and all settlement service providers to expand their geographical markets, lower their costs through increased efficiencies, tap into capital markets, and increase the amount of information and product choices available to the homebuyer.

Finally, the competitive dynamics of the real estate marketplace have dramatically changed since 1974. The maturation of the baby boom generation has increased supply and decreased demand for residential homes, so that more providers of settlement services are competing for fewer customers. As a result, settlement service providers have one of two choices if they want to survive: they can either expand into ancillary services and tap into new markets, or they can artificially maintain high profit margins by restricting entry into their segment of the marketplace by new competitors.

## CONSUMER BENEFITS OF DIVERSIFICATION

RESPRO members have chosen diversification to survive in today's marketplace. We believe that this diversification, or "one-stop shopping", provides significant consumer benefits:

- Greater Consumer Choice: Instead of being forced to use a different provider for each service, homebuyers would have the option of obtaining all or part of the services at one time and place.

- Better Service: Homebuyers could obtain faster, better and more efficient service since providers of one service could better assure the accountability of providers of ancillary services.

- Greater Competition: By allowing companies to (1) diversify their product offerings; and (2) enter geographical markets they normally would not enter because of the costs of establishing separate branches and personnel for separate services, the rule increases competition in the real estate services marketplace.

- Lower Costs: Studies have shown that when settlement service companies are able to diversify into other services, it results in real cost savings for homebuyers:

  -- A 1992 survey of title service costs in the Minneapolis-St. Paul marketplace found that diversified providers charged approximately $13 less per closing for a market basket of title services (buyer's closing, plat drawing, assessment search, name search and record satisfaction) than independent providers.[1]

  -- After all diversified title service providers in the State of Kansas closed down due to a 1990 law pushed by independent title companies that restricted the ability of diversified providers to do business, base closing fees filed in Wichita County by independent title companies with the Kansas Insurance Commissioner jumped from $125 to $200-- an increase of 60 percent.[2]

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[1] "Economic Issues Relating to the Title Insurance Industry In Minnesota: Would Further Regulation Be Helpful?", February 1992, Anton Financial Economics, Inc.).

[2] Id.

– Consumer savings from the elimination of state laws restricting the amount of business a lender may do with its in-house title company-- and the resulting increased competition from the elimination of such restrictions- are estimated at $50 per transaction and approximately $119 million for all homebuyers, based on the 1991 level of mortgage loans in States with such restrictions.[3]

## PROBLEMS WITH PREVIOUS REGULATORY ENVIRONMENT FOR DIVERSIFIED COMPANIES

Unfortunately, companies have never been able to fully provide the consumer benefits associated with diversification and one-stop shopping because of the confusing federal regulatory environment over the last decade.

In the early 1980s, independent title and escrow agents attempted to prohibit or restrict this new competitive force by urging Congress to prohibit or restrict so-called "controlled business arrangements" under the 1974 RESPA law. Congress rejected these attempts and instead established a "safe harbor" under RESPA for controlled business arrangements as long as (1) the consumer is provided with meaningful disclosure of any financial relationship between two companies and the normal range of fees charged for the settlement service; (2) the consumer is not required to purchase more than one settlement service from one company; and (3) the only fees paid between providers within the same controlled business arrangement for referrals of business be a return on ownership interest or return on franchise relationship.

RESPRO supports the statutory framework established in 1983 for controlled business arrangements. The fault for the confusing regulatory environment for controlled business arrangements over the last several years has not been with Congress, but with HUD's failure to fulfill its statutory obligation to provide regulatory guidance under RESPA since 1983.

For almost a decade, HUD stifled the ability of diversified companies to develop innovative products and services for homebuyers by refusing to issue regulations to implement the 1983 controlled business arrangement amendments to RESPA. Until the December 2, 1992 final RESPA rule was issued, diversified companies were forced to rely on a series of HUD opinion letters that often reached inconsistent and vague conclusions about what diversified companies can and cannot offer their customers. Because reputable companies did not want to inadvertently subject themselves to RESPA's criminal or civil sanctions, they were reluctant to offer those products and services that best met the changing needs of their customers and the marketplace. Smaller companies that could not afford expensive legal opinions to provide them

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[3]Regulatory Impact Analysis of the Department of Housing and Urban Development's Final RESPA Rule, November, 1992.

comfort in offering new products and programs were at a particular disadvantage in this unfair and uncertain regulatory environment.

## BENEFITS OF HUD'S 1992 FINAL RESPA RULE

In a 1990 Congressional testimony before the House and Senate, HUD announced it intended to finally issue a final RESPA rule to implement the 1983 controlled business arrangement amendments to RESPA, as well as to provide guidance on computerized loan origination (CLO) fee arrangements. In this testimony, HUD indicated that the final rule would recognize the consumer benefits associated with diversification:

> "We believe that affiliations between companies involved in different aspects of a real estate transaction can, in many instances, benefit the consumer. If lenders affiliate with other settlement service providers, and incorporate the prices of these services into the interest rate on the loan, it is easier for consumers to compare the "package deal" than if they must shop separately for each service. I would add that in some states, the title insurers and escrow agents are tightly regulated, and can set monopoly prices through regulation. In those states, competition for those services can exist only if the services are part of an overall package."[4]

HUD subsequently issued a final RESPA rule that became effective December 2, 1992, which ended the decade of unclear and inconsistent regulatory guidance for diversified companies as to what is and what is not allowed under RESPA.

RESPRO believes that this final RESPA rule recognizes 1983 Congressional intent to allow companies to provide consumer benefits associated with diversification. Significantly, the rule provides that:

- Any settlement service provider may diversify its product offerings by creating affiliations, joint ventures, or partnerships with other settlement service providers ("controlled business arrangements").

- A diversified company may offer its customers multiple products and services at the point of sale ("one-stop shopping").

- A diversified company may offer consumer discounts or rebates if the customer chooses to purchase more than

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[4]Congressional Testimony of HUD General Counsel Frank Keating, September 18, 1990.

one product or service from the company.

- A diversified company may compensate its management and non-real estate agent employees for developing and implementing programs involving the cross-marketing or multiple products and services.

HUD's final RESPA rule also follows Congress' intent to provide adequate consumer safeguards against potential abuses when dealing with diversified companies:

- Diversified companies must disclose in writing the nature of any business relationship between any two providers, the estimated charge of the settlement service being provided, the fact that the customer is not required to purchase one product or service to get another, and the fact that the customer may be able to help to get the service at a lower rate by shopping with other companies. A standard disclosure form (Attachment 4) is provided in the rule.

- A diversified company may not require the customer to purchase one of its products or services in order to purchase another product or service ("anti-tying" provision) (Section 3500.15(b)(2)).

- No affiliate in a diversified company may directly or indirectly pay another affiliate for a mere referral of business (preamble discussion of Section 3500.15 (b)).

- Any consumer discount on the purchase of "packaged" services must be a "true" discount and cannot be made up by higher cost elsewhere (Section 3500.2(11)).

- Diversified companies cannot offer a product or service as part of a "package" that it does not offer separately (Section 3500.2(11)).

- Providers of multiple settlement services must perform distinct services in return for each payment they receive (Section 3500.14).

HUD's Regulatory Impact Analysis of the final RESPA rule estimated that the consumer savings from allowing diversified companies to cost-efficiently offer and market multiple products and services for homebuyers at the same time and/or place <u>are estimated at up to $150 per transaction and up to $148.5 million for all homebuyers</u>. Attachment 5 to this testimony includes articles that summarize many other significant consumer benefits that will flow from HUD's new RESPA rule.

**MANAGEMENT COMPENSATION**

One provision under the controlled business arrangement provisions of HUD's final RESPA rule deserves further discussion because it has been so misinterpreted by independent providers of services that fear competition from diversified companies.

Section 3500.14(g)(2) of the new rule provides that "RESPA does not prohibit...an employer's payment to its own employees for any referral activities." The rule also makes clear that such payments cannot be reimbursed by the party receiving the referral or be made to non-employees. Thus, contrary to much of the publicity surrounding this rule, this provision does not apply to real estate agents, which are considered independent contractors, and not employees. We do believe, however, that the ability to compensate managers of diversified companies, which is permitted by the rule, is crucial to the continued existence of diversified companies in the real estate marketplace.

A diversified company that wants to offer one-stop shopping to homebuyers will naturally assign this responsibility of developing products and implementing programs to its management. Without the ability to compensate management in accordance to their job performance, diversified companies would not be able to efficiently offer one-stop shopping for homebuyers.

The ability to compensate management for developing and implementing cross-selling programs is also consistent with Congressional intent. Nothing in the legislative history of RESPA suggests that RESPA was ever intended to prohibit companies from compensating their management and employees for their oversight of marketing and managing the delivery of real estate services. To the contrary, Congress' decision to provide a safe harbor for controlled business arrangements was predicated upon Congress' desire to permit consumers to enjoy the efficiencies that such arrangements can bring to the marketplace.

**SUMMARY**

In summary, RESPRO strongly believes that today's homebuyers and real estate marketplace require a regulatory environment that allows companies to offer multiple products and services for homebuyers at one time and/or one place by establishing affiliations, joint ventures, and partnerships with other companies. By finally providing settlement service providers with a clear and consistent regulatory environment that allows companies to diversify in the most cost-efficient manner possible, HUD's final RESPA rule will increase consumer choice, enhance consumer service, increase competition among providers of services for homebuyers, and lower the costs associated with buying a home.

Thank you for the opportunity to testify. I would be glad to answer any questions.

RESPRO
REAL ESTATE SERVICES PROVIDERS COUNCIL
1747 PENNSYLVANIA AVENUE, N W • SUITE 850 • WASHINGTON, D C 20006 • (202) 833-5055

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## REAL ESTATE SERVICES PROVIDERS COUNCIL (RESPRO)

### Mission Statement

An open and competitive marketplace which allows businesses to develop and distribute products and services that best meet the needs and demands of consumers has always served as a cornerstone in this country's economic growth by expanding consumer choice and lowering long-term consumer prices.

Unfortunately, the ability of homebuyers and sellers to shop for real estate-related services (i.e., real estate brokerage, mortgage loans, title services, homeowners insurance) has been threatened in recent years by excessive government interference in the ability of businesses to improve cost efficiencies, customer service and customer convenience by offering homebuyers and sellers multiple products and services at one time and/or one place.

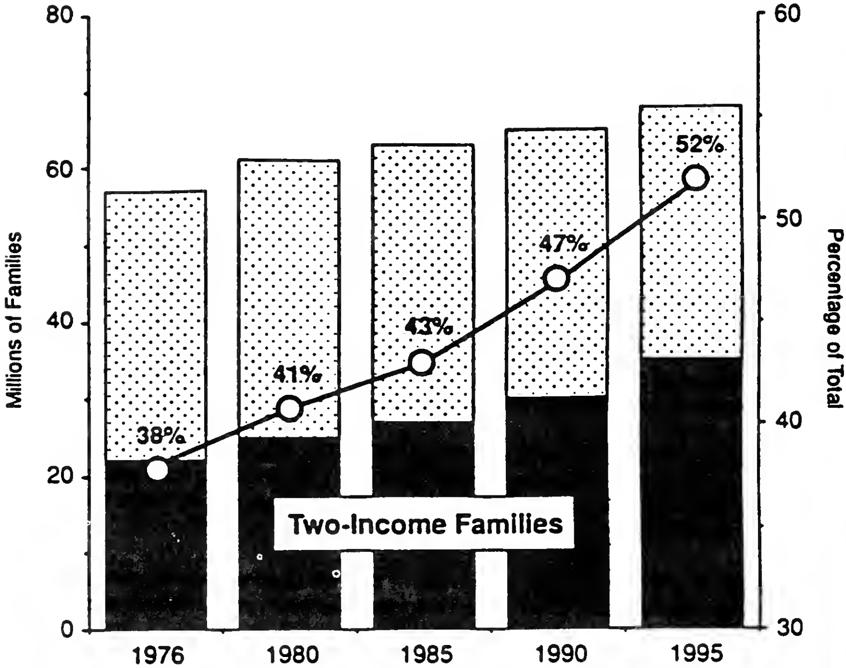
This excessive government interference has taken form in Federal or State laws and regulations that ban or restrict affiliated companies, joint ventures, or partnerships from cost-efficiently offering and delivering multiple products and services for homebuyers and sellers. Specific proposals have included percentage caps on joint marketing among companies that share a financial interest, prohibitions on discounts or rebates on the purchase of multiple products, and restrictions on the ability of an employer to compensate its employees for marketing products of more than one provider.

The Real Estate Services Providers Council (RESPRO) supports a Federal/State regulatory environment that enhances the ability of a business to cost-efficiently offer and market diversified products and services to any homebuyer or seller through a subsidiary, division, joint venture or partnership.

We will work to provide an agenda for reform that will assure homebuyers and sellers a competitive marketplace, lower costs, convenience and more product choice.

We will work with Members of Congress, the 50 state legislatures, and Federal/state rulemaking bodies to accomplish these goals.

## *The Increasing Importance of Two-Income Families*




*Source: Futures Group*

49622 Federal Register / Vol. 57, No. 212 / Monday, November 2, 1992 / Rules and Regulations

APPENDIX D TO PART 3500 -

CONTROLLED BUSINESS ARRANGEMENT DISCLOSURE STATEMENT FORMAT

Notice

To: Buyer or Seller ______________ Property:

______________

From: [Entity Making Statement] ______________ Date:

This is to give you notice that [referring party] has a business relationship with [provider]. [Describe the nature of the relationship between the referring party and the provider, including ownership and financial interests.]

Set forth below is the estimated charge or range of charges by [provider] for the following settlement services:

______________: $______________

______________: $______________

______________: $______________

You are not required to use [provider] as a condition for [settlement of your loan on] [or] [purchase or sale of] the subject property. You may be able to get these services at a lower rate by shopping with other settlement service providers.

A lender is allowed to require the use of an attorney, credit reporting agency or real estate appraiser chosen to represent the lender's interest.

THE WASHINGTON POST FEBRUARY 21, 1993

JANE BRYANT QUINN

# One-Stop Shopping For a New House

New rules from the U.S. government have opened the door to the future for home buyers. Real estate firms may now offer one-stop shopping: House, mortgage application, title insurance and other home-buying services, all available from the same office or wrapped in a one-price package.

To profit from this system, you'll have to be a well-informed shopper. You don't want to stumble into a package that, though convenient, is overpriced. If done well, however, one-stop shopping shouldn't cost any more than you currently pay, and may cost less.

The rules, from the Department of Housing and Urban Development, amount to a clarification of current consumer protection legislation. Here's what real-estate brokerage firms will be able to do:

- Install a computer terminal that displays a variety of different mortgage loans. Once you've chosen a house, you can move to another desk in the firm and shop for a mortgage on the spot. In other words, the firm will act as your mortgage broker. Your loan application will be handled electronically, through a system known as "computerized loan origination."
- Own an interest in other home-buying services that it recommends to you, such as home inspections, title insurance and homeowner's insurance.

The price you'll be charged has to be disclosed in writing in advance, as does the broker's affiliation with the other service firms. If you don't li[illegible] the broker's terms or fees, you must be free to go somewhere else.

Computerized loan origination systems have been in development for many years. But for business and regulatory reasons, they have never caught on widely.

Coldwell Banker Residential Real Estate, a national real estate brokerage company owned by Sears, Roebuck and Co., offers a computerized loan-origination service called Borrower's Choice at some of its offices in central and northern New Jersey, although the system will be expanded. Home buyers can check through the loans of 12 to 25 lenders, including those from Sears Mortgage. Borrowers don't pay for this service; all the fees are covered by the lenders, says Chandler Barton, head of Coldwell Banker's Residential Group.

Prudential Real Estate Affiliates has a computerized loan origination service, but is revamping it. Right now, it lists just two national lenders, Prudential and Countrywide Funding. But Joe Bryant, president of Prudential Real Estate Services, says that the system will be expanded. Sally Sciacca, a legislative analyst for the National Association of Realtors, expects new systems to be unveiled that will give open access to any lender who wants to participate.

That brings up the risk of a computerized loan service. As long as you can compare the costs of loans at least eight or 10 lenders, you'll probably get a competitive rate. But what if your real estate broker offers loans only from a single lender? That can be lucrative to the broker, because lenders will pay extra for exclusivity. But clients who don't price shop may be steered to a more expensive mortgage than necessary. Even in multilender systems, one lender may be favored—because it's affiliated with the broker or pays the broker a higher fee.

The Mortgage Bankers Association of America has filed a lawsuit to reverse the government's new rules, arguing that they contravene the law that protects real estate buyers from abuse.

It's unlikely that uncompetitive single-lender systems can succeed today. Home buyers are pretty sophisticated about mortgage rates, which are published in newspapers. But that's not to say that other lenders won't try.

Carolyn Weber, vice president of Century 21 of the Northeast, says that a number of banks have approached her, wanting to set up single-lender systems for Century 21 offices.

If computerized loan origination services did become abusive, the Department of Housing and Urban Development would have to act again. But I believe the future lies in computerized mortgage shopping. Eventually, you'll be able to tap into databases and apply for a mortgage through your computer at home.

Overpriced mortgages may be easy to spot. But it's harder for buyers to know if they're paying fairly for ancillary services such as title insurance. Good real estate brokers will be competitive, but you still need to check the price of an outside company just to keep everybody honest.

The Washington Times

COMMENTARY

SUNDAY, NOVEMBER 8, 1992

WAYNE T. BROUGH

# Home-buying without hassle

Buying a home, one of the most confusing transactions the consumer con undertake, is getting easier and possibly cheaper. Last Monday, the Federal Register published new regulations from the Department of Housing and Urban Development that will untangle the red tape facing a potential homebuyer. HUD has put an end to 10 years of confusion by issuing a rule that has been bottled up since 1983, when Congress amended the Real Estate Settlement and Procedures Act (RESPA). According to HUD Secretary Jack Kemp, "It's time to do away with the uncertainty within the real estate industry that has stymied innovation and denied the consumer more cost-effective services."

Real estate settlement rules have changed little since 1974, when RESPA was first passed by Congress. Despite amendments in 1993, HUD did little to clarify acceptable business practices under RESPA. Under the threat of civil and criminal penalties, real estate and settlement service providers were hesitant to innovate or provide new services for the homebuyer. Indeed, HUD was actively bringing lawsuits against those who tried. Consequently, homebuyers suffered through settlement procedures that were outpaced long ago by technology and changing consumer needs.

The new RESPA rule is the first real attempt to reform the settlement process; even HUD acknowledges that "the contents of this regulation will have a major impact on the manner in which nearly all mortgage loans will be obtained by prospective borrowers." For the consumer, this is good news. The market for settlement services has just become more competitive, which means lower prices and services streamlined to meet the needs of the homebuyer. The HUD rule allows new business arrangements among various settlement service providers as long as the consumer is kept fully informed about the relationships and there is no requirement to use the services of a particular individual or company.

Typically, buying a new home requires a number of transactions, including real estate services, mortgage lending, home insurance, warranties, title searches and escrow services. In the past, consumers were forced to go to a different provider for each service. Under the new rule, consumers now have the option of obtaining these services as a package deal. With full disclosure and other safeguards, consumers are still protected from excessive costs while spending less time and money on settlement. In fact, customer rebates or discounts are possible under the new rule.

*The modification will foster innovation and remove unnecessary barriers to real estate transactions. The new RESPA rules for settlement services could lower costs to consumers and help the struggling real estate industry.*

Through new business arrangements, services will be offered at lower fees because overhead costs will drop. In addition, the number of services offered at the point of sale can increase. Settlement providers offering one-stop shopping can enter new markets because it is no longer necessary to incur the costs of creating branches for each separate service. Preliminary estimates suggest that these new arrangements can reduce closing costs by 10 percent, or $300 on the typical closing costs of $3,000. A conservative estimate by HUD suggests that consumers as a group can save $500 million annually through the use of new business arrangements.

Real estate related service providers from all sectors of the market are working on innovations such as offering multiple products and services at the point of sale. Substantial discounts and possibly free services have been proposed for homeown who take advantage of one-st shopping. Moreover, in the wake the computer revolution, a lo company can easily provide loan formation from mortgage com nics outside the borrower's g graphical area. Innovation a renewed competition not only p vide opportunities for lower pri and more convenience for t homebuyer, but also more effici markets for real estate and sett ment services.

Of course, not everyone is hap with HUD's action. The mortga banking industry has already beg a campaign against the new rul But as Alfred DelliBovi, deputy s retary at HUD, stated, the mortga bankers "wanted HUD to guarant that the fees be paid only to mo gage bankers. They wanted a corn on the market." New competiti from the real estate industry c into the traditional domain of t mortgage bankers and reduces th profit margins.

Mr. Kemp has paved the way dramatic changes in the real est industry. The modification will f ter innovation and remove unnec sary barriers to real estate trans tions The new RESPA rules settlement services could lo costs to consumers and help struggling real estate industry

*Wayne T. Brough is an economist with Citizens for a Sound Economy Foundation, a 250,000-member grassroots research and education organization located in Washington.*

The Washington Times

COMMENTARY

FRIDAY, DECEMBER 11, 1992

SAMUEL BRUNELLI

# Broader real estate options

Imagine yourself the quarterback of a football team. You think you've led your team across the goal line for the winning touchdown as the clock is ticking down to end the game. It's been a tough, grueling fight, but you've won — until the opposing team tries to persuade the referee that the goal line ought to be moved.

That's probably just how Secretary of Housing and Urban Development Jack Kemp is feeling right now. Like him or not, Mr. Kemp is a man with real vision. A strong proponent of open and fair competition in business and industry, a true believer in the efficiency of the marketplace and no champion of those who seek protection from competition behind the skirts of government.

It's that vision that prompted Mr. Kemp to battle the bureacracy and special interests and issue, in November, long-awaited rules that will open markets, increase competition, and spur innovation in the real estate services industry. The rules, which went into effect on Dec. 2, apply to the Real Estate Settlement Procedures Act (RESPA), which provides consumers protection during the settlement process of buying a home.

The new rules would allow real estate firms the opportunity to provide a wide variety of services — such as mortgages, homeowners' insurance, title services, warranties and others — which they have been generally prohibited from providing in the past.

By dramatically expanding the number of potential companies in the field, companies will be competing for clients, price competition will become a reality, and innovative services to reduce costs and increased consumer convenience will be encouraged.

Sounds good, doesn't it?

Well, it's not so good if you're a member of the mortgage finance industry. These new rules will inject something the mortgage bankers and their allied interests have rarely had to face in the past: competition from companies outside their industry.

So that's why those who oppose the rules are lobbying the new Clinton administration and Congress to move the goal line back.

How did we get into this mess?

RESPA was passed by Congress in 1974, and amended in 1983, to provide home buyers more meaningful disclosure of real estate settlement fees and protect them against unnecessarily high costs. In the Act, the Department of Housing and Urban Development (HUD) was created to interpret RESPA through rulemaking.

For nearly a decade, HUD played a protracted game of cat and mouse with the real estate industry about what the rules would be and what they would mean. Indeed, HUD bureaucrats issued private opinions to those in the real estate industry — opinions which have been confusing and inconsistent. At the same time, HUD threatened legal action against companies who try to offer innovative services that could increase consumer choices. As a result many companies have backed off from developing new services for homebuyers.

Mr. Kemp thought that consumers were entitled to those choices. As he explained when releasing the rules, "By creating more competition in the marketplace, it [the rules] will lower costs to homebuyers when they make the most important purchase of their lives, and it ensures that consumers are fully informed of all the fees involved in a real estate settlement."

Last week, groups representing the established mortgage finance industry unleashed a blitz on Capitol Hill. Their goal? Create enough congressional pressure to overturn the rules. The reason? To keep the costs of buying a home — and the profits — under their control. After all, if consumers could get high quality services from more than one provider, they might just pick the least expensive, which would hurt profits in the established mortgage industry.

Wouldn't that be terrible?

Of course not. Consumers should be able to pick and choose real estate services, just the way they can pick and choose when they buy other services. Competition and consumer choice are key to ensuring economic growth, which is vitally needed in today's real estate services market.

Those who opposed the RESPA rules should recognize that the game is over. The touchdown was scored and the nation's consumers won. Those who opposed the RESPA rules should quit trying to move the goal line and begin preparing for the next game — one in which the competition will be tougher, and more beneficial, to the nation's homebuyers.

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*Samuel A. Brunelli is Executive Director of the American Legislative Exchange Council (ALEC), a national bipartisan organization of state legislators.*

Reprinted from THE WALL STREET JOURNAL.

THURSDAY, JANUARY 7, 1993 

# *Good News for the Home Buyer—At Long Last*

By CASSANDRA CHRONES MOORE

After nine years of waffling in negotiations with the real-estate industry, bankers and Congress, the Department of Housing and Urban Development has finally laid down its very long awaited rule to make buying a house or condo simpler. The ruling reveals what HUD considers to be legal programs under the 1983 Controlled Business Amendment to the Real Estate Settlement and Procedures Act (Respa) of 1974. Clearly caution was its watchword.

Passed to quell interminable disputes over the interpretation of Respa, the Controlled Business Amendment was to allow the establishment of "settlement service centers" to handle not only real-estate sales but necessary adjuncts, such as mortgage lending, title searches and homeowners insurance. The increased efficiency of "one-stop shopping" would allow the service provider to lower its costs and pass the savings on to the home buyer. For the average consumer, streamlining the settlement process would mean a welcome saving of time as well as money.

Instead of quickly issuing a rule to encourage that streamlined process, HUD consistently raised obstacles. A 1989 draft rule would have, in practice, prevented a settlement service center from paying its employees commissions to offer the products of affiliates. Disclosure of the arrangement to the consumer would have made no difference. Nor was it relevant that an affiliate might be offering a loan at very favorable rates and terms. The draft rule all but prohibited discounts, a blow to the consumer.

Endless hours of negotiation between the government and the real-estate industry resulted in a virtual stalemate. Diversified companies hesitated to promote integrated settlement services that would speed property transfers while lowering costs to the consumer for fear of incurring heavy civil and criminal penalties. Without agreed upon rules governing the payment of employees and the pricing of services, HUD was free to conduct a fishing expedition for supposed violators, and it did so.

**REGULATORY CHOKEHOLD**

Late in 1991, it created its Respa Enforcement Unit, a six-man SWAT team that doggedly tracked down alleged Respa violators. It even encouraged competitors to inform on each other. By a year later, capitalizing on the industry's confusion about what exactly constituted compliance and the willingness of competitors to point an accusing finger, the unit had initiated roughly 200 investigations. Whether they benefited the consumer is doubtful: that they cost taxpayers a bundle is certain.

Ironically, the HUD rule, which took effect on Dec. 2 after nine years of wrangling, underlined the safeguards outlined in the 1983 amendment, reinforcing the original legislation: The existence of the Controlled Business Arrangement and the relationship between the firms must be disclosed in writing; the consumer is still free to obtain the services through nonaffiliated firms if those are cheaper or offer a more attractive package of services. By fostering competition, these rules will result in better buys. Moreover, as stipulated by Respa in 1974, there can be no kickbacks; fees must be charged for services performed, rather than simply for the referral of business. Over nearly a decade little had changed but the blood pressure of the negotiators.

Similar obstacles bedeviled expansion of Computerized Loan Origination Systems (CLOs), despite their substantial benefits to the buyer. These computerized displays installed in real-estate offices could permit agents to offer the services of one or more mortgage lenders at the point of sale. The potential borrower or the mortgage lender would pay the agent for processing a preliminary loan application, a big time-saver. Despite these advantages, Respa's lack of clarity, combined with HUD's unwillingness to let the marketplace set prices and its overbearing drive to "protect" the consumer from supposedly inflated prices, fueled lengthy debate over payment.

The question of fees to be charged, in fact, laid bare HUD's price-fixing heart. During 1990 testimony before the House Subcommittee on Housing and Community Development, Francis Keating, HUD's general counsel, proposed establishing a limit on fees for CLO services. In the name of consumer protection, Mr. Keating declared "that the fee should be capped at a fixed dollar amount *which would be set to reflect the reasonable cost of providing such a service. . . . However, we have not yet determined what we would consider to be an appropriate, reasonable fee. . . .*" (Emphasis mine.) Of course not! A freely functioning market would set a "reasonable fee," a charge based on the cost of supplying information. It would reflect the demand of consumers for the service and its profitability for the supplier.

Intent on controlling the marketplace, HUD flunked the basics of Economics 101. Fearful of supply and demand, it preferred price-fixing mechanisms resembling those of a socialist state. Its timidity seriously impeded the growth of the CLOs, hampering consumer choice and preventing the home buyer from enjoying a convenient service and lower prices.

Happily the real-estate industry, by emphasizing potential advantages to the consumer, was able to counter not only HUD's proposed restrictions on real-estate brokers offering the system but the lobbying of the Mortgage Bankers Association. (The MBA had insisted that the CLO charge represented the simple referral fee long prohibited by Respa, rather than a fee for services performed.) In a victory for the free market, the rule as promulgated allows real-estate brokers to charge whatever fee the broker determines to be fair for the service, provided he or she discloses the fee in writing to the consumer.

To be charitable, one could congratulate HUD on the final agreement. But the waste of nine years in time and money gives the congratulations a hollow ring.

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*Ms. Moore is an adjunct scholar at the Competitive Enterprise Institute.*

AMERICAN
LAND TITLE
ASSOCIATION

1828 L Street, NW
Washington, DC 20036-5104
202/296-3671
800/787-ALTA
FAX 202/223-5843

TESTIMONY OF ROGER N. BELL
PRESIDENT
THE SECURITY ABSTRACT & TITLE COMPANY, INC.
WICHITA, KANSAS

IMPACT OF REGULATIONS
UNDER THE
REAL ESTATE SETTLEMENT PROCEDURES ACT
ON
SMALL BUSINESS

on behalf of
THE AMERICAN LAND TITLE ASSOCIATION

before the

COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

JULY 1, 1993

My name is Roger Bell and I am president of Security Abstract and Title Company of Wichita, Kansas. I am pleased to appear before the Committee today representing the American Land Title Association, the national association of the land title industry, and an association I was privileged to serve as president in 1978/79.[1/] I am accompanied by Ann vom Eigen, ALTA's Legislative Counsel.

ALTA is pleased that the Chairman is holding this hearing to explore the effects on small business of the regulations issued by the Department of Housing and Urban Development on November 2, 1992, in implementation of the 1983 controlled business amendments to the Real Estate Settlement Procedures Act ("RESPA"). These regulations directly affect the members of ALTA, many of whom are sma: businesses engaged in the abstracting and title insurance agency business. I am here representing the association because in a number of regards the regulations encourage arrangements and practices that I and other small businesses have had to face in Kansas. These are practices that our state insurance department and legislature have addressed, but their solutions have been called into question by certain aspects of the new regulations.

ALTA believes there are three major areas of concern with the regulations. First, the new regulations make it even more difficult for independent small businesses, such as my own, to compete with title companies owned by controllers of business, such as the large real estate brokerage companies. Apart from encouraging the packaging of settlement services in which independent companies have no real opportunity to become part of the broker's package,

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[1/] The American Land Title Association membership is composed of 2,000 members, including title insurance companies and over 1,900 title insurance agents, abstractors, and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders and others with interests in real estate against losses from defects in title. These firms and individuals employ nearly 100,000 persons and ALTA members operate in every county in the country.

the regulations authorize the payment of bonuses and other incentives by real estate brokers to their employees as an inducement for those employees to steer the consumer's business to the broker's captive company, rather than recommending the services of the company that will provide the best combination of price, quality and service to the consumer.

Second, the new regulations purport to authorize the Secretary of HUD to preempt state legislation or regulations that provide more restrictive limitations on controlled business even though Congress made clear in the 1983 amendments to RESPA that more stringent state limitations on controlled business arrangements were not to be affected by the RESPA amendments. This aspect of the regulations has created substantial confusion among state insurance regulators and state legislators who are being led to believe -- contrary to Congress' clear intent -- that their legislation or regulations may be preempted by the HUD regulations.

Third, the provisions of the regulations that require title insurance agents to perform certain "core title services" are creating significant confusion because of certain ambiguities regarding the parties to whom such requirements apply and the nature of those core service requirements. These are technical issues that we hope will be addressed and remedied by HUD in the near future.

Controlled Business Arrangements: The 1983 RESPA Amendments and the New HUD Regulations

Because consumers purchase real estate so infrequently and are generally pre-occupied with other matters between the signing of the purchase contract and the closing, they inevitably look to and rely upon their real estate broker or lender for a recommendation or referral in selecting a title company. Like many other types of settlement service providers, such as mortgage bankers, appraisers, and surveyors, a major part of our business is based on referrals from those parties. Section 8 of RESPA, which was part of the statute as originally

enacted in 1974, prohibits the payment of kickbacks and referral fees as a means of influencing those recommendations.

The years following the enactment of RESPA witnessed the growth of "controlled business arrangements." These are arrangements where a person in a position to influence the consumer's selection of a settlement service provider, such as the real estate broker, owns or has a financial interest in a title insurance agency. Because of its ownership interest in the captive affiliate, the controller of business has a significant financial interest in steering consumer business to that agency. As a consequence, other independent title agents, most of whom are small businesses, find themselves unable to compete effectively for the referrals of that broker and, indeed, may be completely frozen out of the ability to compete for title insurance business in transactions handled by the brokerage company or lender that has a captive title insurance agency.

The 1983 controlled business amendments to RESPA were the culmination of several years of hearings and deliberations by the Congress on the problems of controlled business. One alternative Congress considered was to require that all settlement service providers such as title companies obtain a certain portion of their business from the public, rather than relying exclusively on referrals from the controllers of business that have an ownership interest in the company. In the end, Congress decided not to go that far, but to specify that controlled business arrangements would not be a violation of RESPA if certain conditions were met (i.e., the nature of the arrangement was disclosed to the consumer, the consumer was not required to use the captive company, and no other thing of value was paid to induce the referral of business other than normal dividends or returns on the ownership interest).

The Employer/Employee Referral Fee Rule

Unfortunately, the new RESPA regulations go beyond what Congress prescribed and have the potential to have a devastating effect on small, independent businesses that are trying to compete for business on the merits of their products, prices and services. One of the most significant problems for the title insurance industry is created by the provision of the regulations that permits an employer to pay a bonus or fee to an employee for the referral of the consumer's business to a settlement service provider affiliated with the employer. For example, a real estate brokerage company can pay an office manager, or a mortgage lender can pay its loan originator, an incentive bonus or fee to encourage that office manager or loan originator to steer business to the controlled title agency affiliated with that brokerage company or lender. Not only is this regulation contrary to the Congress' determination that no other thing of value be paid or received in the controlled business arrangement (other than the payment of bona fide dividends), but it permits the broker or lender to pay the type of referral fee that section 8 prohibits independent companies from paying. If an independent company tried to make a similar payment to the office manager or loan originator, it would be subject to the criminal and civil sanctions of RESPA.

In the absence of such referral fees and inducements to employees, independent small businesses would at least have a fighting chance to persuade the broker's or lender's employee that they can provide better service or quality or rates and to consider recommending their companies to the consumer. In the face of such bonuses and referral fees, however, it is hardly surprising that many independent providers find that they are completely unable to compete for referrals and, in some cases, cannot even get in the front door to leave any information about their services.

I would point out that controlled business arrangements and employer/employee referral fees not only threaten independent small businesses, they are also at odds with the best interests of consumers. Recently, the Consumer Federation of America, one of the largest and most respected consumer organizations in the country, filed a friend of the court brief in a lawsuit challenging HUD's employer/employee referral fee rule. In that brief, CFA made clear the interest of consumers in this issue when it wrote:

> The employer referral fee rule encourages employees of brokerage firms and mortgage lenders to steer the consumer to the employer's controlled business affiliate even if other firms can provide better prices, quality, or service. It is simply unrealistic to believe that allowing such payments will not determine the direction of referrals. Moreover, the controlled business affiliate does not have to compete on the merits for the recommendation of that employee when the affiliate knows that the employee will be receiving a direct financial incentive from his employer to steer business its way. As a consequence, consumers will not only end up having to pay for such fees, but the entire dynamics of competition among settlement service providers becomes altered to the detriment of consumers. Indeed, if controlled business arrangements continue to develop, and employer referral fees are permitted to be paid to ensure that consumers get steered to the broker's or lender's affiliate, there is a great danger that few if any consumers will be able to escape the one-way highway of financially-induced referrals to captive affiliates.[2/]

Another problem that is of concern to independent small businesses is the fact that the final regulations encourage real estate brokers and lenders to package settlement services and to include only controlled business affiliates in that package. While we have significant doubts about the consumer benefits of packaging, if such packaging is encouraged it is important that companies other than the broker's or lender's controlled title company have a fair opportunity to compete to be included in the package. The new regulations fail to ensure that these competitive opportunities are kept open to all companies.

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[2/] Amicus Curiae Brief of Consumer Federation of America, Coalition to Retain Independent Services in Settlements v. Cisneros, U.S.D.C.D.C., Civil Action No. 92-2700 (CRR) at 20-21 (May 20, 1993).

HUD's Purported Preemption of State Controlled Business Provisions

When Congress enacted the controlled business amendments to RESPA in 1983, the House Banking Committee was aware that the National Association of Insurance Commissioners was considering recommending to the states the adoption of more stringent limitations on controlled business arrangements (i.e., requiring that controlled title agencies obtain a significant portion of their business from sources other than referrals by their owners). To avoid any ambiguity that such state laws or regulations would not be preempted by the RESPA amendments, the Banking Committee included an amendment to section 8(d)(6) of RESPA unequivocally stating that:

> No provision of state law or regulation that imposes more stringent limitations on controlled business arrangements shall be construed as being inconsistent with this section.

This language was part of the 1983 RESPA amendments approved by Congress. The Banking Committee explained in its report on the amendments that "the controlled business amendments to Section 8 of RESPA should in no way inhibit the individual states in which controlled business may be a significant problem from adopting those additional measure that they [the states] believe will protect consumers and competition."[3/]

The statutory and committee language was directed at the kind of controlled business legislation that my state of Kansas enacted in 1989, a matter I will discuss in a moment. What is critical here is that the new RESPA regulations completely pervert the meaning and intention of what Congress had decreed. Section 3500.13(b)(2) of the regulations suggest that only if the Secretary of HUD determines that state controlled business provisions give more protection to consumers and competition would the state provisions not be preempted.

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3/ Report of the House Committee on Banking, Finance, and Urban Affairs on the Housing and Urban-Rural Recovery Act, H.R. 98-123, 98th Cong. 1st Sess. (1983) at 77.

This aspect of the regulations has received quite a bit of publicity in many states and is being used to frighten state legislators and regulators into believing that the RESPA disclosure provisions preempt more stringent state legislation or regulations. Indeed, this view was urged upon the Insurance Department in Kansas shortly after the RESPA regulations were promulgated. Fortunately, we were able to convince the Department that this regulation was clearly contrary to the RESPA statute and the Banking Committee report.

Our experience in Kansas demonstrates the problems with this aspect of the regulations and the importance of ensuring that the states continue to have the freedom to limit controlled business arrangements when they believe that such action is in the best interests of their citizens. In 1986 the Kansas Insurance Commissioner became concerned about controlled business arrangements that had developed in a number of areas in our state. He concluded that, while these arrangements violated the spirit and intent of Kansas' anti-kickback statute, they did not violate the letter of the law. He appointed a study group, composed of representatives of the lending, real estate brokerage and title insurance industry, to consider what should be done. Based on the committee's recommendations, the Commissioner proposed legislation to the Kansas legislature that would limit the amount of controlled business any title company could engage in. This legislation was enacted in 1989 and was immediately challenged as unconstitutional by two controlled business companies affiliated with major real estate brokerage companies. In January of 1991 the Supreme Court of Kansas unanimously upheld the constitutionality of the statute.

The Kansas controlled business legislation has played an important role in preserving competition in our state and in ensuring that independent title insurance agents, such as myself, have a fair opportunity to compete for business. Other states, such as Minnesota, are currently considering similar legislation to deal with the controlled business problem in their states. Unfortunately, the HUD regulations are being cited in those states to argue that any

legislation the state enacts will be for nought because RESPA has preempted the field. ALTA has brought this problem to the attention of the new administration at HUD and we are hopeful that they will make clear that state laws in this area are not preempted.

Core Title Agent Services

The core title agent services provisions in the new regulations represent an attempt to define the basic services that a title insurance agent must perform to avoid his compensation or commission being viewed as a violation of RESPA section 8. It is intended to address the situation where title insurance agents, frequently those involved in controlled business arrangements, obtain commissions or compensation for being a "full service agent" even though they do not perform or assume responsibility for the types of services that full service title insurance agents typically perform. While the primary purpose is to ensure that consumers do not pay unnecessarily high fees for services that are not rendered or are duplicative of other services the consumer is already paying for, the core services requirement also helps ensure that controlled business title agencies will have to provide the same level of real and valuable services as an independent title insurance agents must provide. In this regard, the core services requirement helps assure a more level playing field between independent and controlled title companies.

There are, however, certain shortcomings in the current language of the regulations that we have brought to HUD's attention. If HUD is able to refine the regulations so as to better define the types of core services that must be provided, and to reflect the variations in settlement practices that take place in different parts of the country, we believe that the core services requirement will be of value in ensuring that all title insurance agencies have to provide real and valuable services.

Conclusion

As the House committee charged with responsibility for the well-being of small business in America, we appreciate the fact that this committee is so vitally concerned about the continued growth of anti-competitive controlled business arrangements in the real estate settlement industry. We recognize, of course, that the 1983 RESPA amendments did not proscribe such arrangements. Nevertheless, we hope that the members of the committee express their concern about the HUD regulations in implementation of those amendments that permit or encourage practices engaged in by controllers of business that exacerbate the difficulties of independent small business entities in competing for settlement service business.

Accordingly, we urge the members of the Committee to encourage HUD to reconsider and revise its regulations on employee referral fees and the preemption of state controlled business provisions. Should Congress choose to revisit the approach to controlled business adopted in the 1983 RESPA amendments, we suggest that consideration be given to the type of approach that has been adopted in Kansas to ensure that all companies must compete in the marketplace for their business.

On behalf of ALTA I thank you for the opportunity to present our views and concerns. I would be happy to answer any questions.

Statement of the

# NATIONAL ASSOCIATION OF REALTORS®

*The Voice for Real Estate™*

**THE WORLD'S LARGEST TRADE ASSOCIATION**

TESTIMONY OF

PALL SPERA

BEFORE THE HOUSE SMALL BUSINESS COMMITTEE

OF THE

U.S. HOUSE OF REPRESENTATIVES

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## INTRODUCTION

Mr. Chairman, Members of the Committee, my name is Pall Spera. I am a REALTOR® from Stowe, Vermont and the 1993 Chairman of the Public Policy Coordinating Committee of the NATIONAL ASSOCIATION OF REALTORS® (NAR). I am the President of a real estate brokerage firm with twenty REALTOR® Associates and two appraisers and am representing the 750,000 members of the Association. I would like to thank you and the Members of the Committee for this opportunity to present the views of our members on the Department of Housing and Urban Development (HUD)'s final rule implementing the 1983 amendments to the Real Estate Settlement Procedures Act (RESPA). Of particular concern to the real estate brokerage industry are REALTOR® involvement in the mortgage process through computerized loan origination (CLO) and the continued ability for our members to participate in diversified financial services companies known as "controlled business arrangements" (CBAs).

My testimony will provide (1) a general statement of support on behalf of the NATIONAL ASSOCIATION OF REALTORS® for the Department of Housing and Urban Development (HUD)'s final rule, effective December 2, 1992; (2) an overview of recent trends in the real estate brokerage industry and the implications of those changes for the continued profitability of our industry; (3) a discussion of computerized loan origination and REALTOR® involvement in same; (3) consumer benefits derived from point of sale delivery of mortgage-related services; (4) a legislative history of the intent of Congress in addressing the issue of CBAs in 1983 and HUD's successful implementation of that intent in the final rule; (5) a summary of NAR's development of policy with respect to RESPA; and (6) concluding remarks as to the kind of legislative and regulatory environment that is needed to bring the mortgage process into the 21st Century.

Because the focus of this Committee is small business, I will attempt to frame the issues in terms of the benefits that HUD's final rule, if left unchanged, will bring to the thousands of small business men and women who represent the majority of NAR's membership. The 1990 median income of brokers is $31,400 while the median income of salespersons is $22, 500.[1]

### NAR Support for the HUD Rule

The NATIONAL ASSOCIATION OF REALTORS® commends HUD for issuing a rule that is a victory for consumers. It removes the artificial boundaries between different types of real estate

services associated with the sale and purchase of a home and allows real estate professionals to join forces with other providers of settlement services to offer multiple services for homebuyers and sellers at one time/or in one place. While we do not expect our members to abandon real estate brokerage as their primary source of revenue, we believe in the right of all independent business men and women to choose how they wish to grow with the industry. Had the final regulations curtailed these rights, the industry and consumers would have borne the cost. Putting aside the industry turf battles of the last decade and fears about "potential" abuses that seem to invariably be associated with change, our testimony will examine the more meaningful issue of how the role of real estate professionals is changing, the forces driving that change and the competitive tools needed to survive the transition. The primary focus is technology and the real estate brokerage industry, but similar arguments could be presented for other settlement service providers as well. The answer for them is the same as for us. We will have to change some of our old ways of doing business to meet consumer demand for versatility and better service. Real estate firms, in particular, will have to diversify as their clients and customers become more conversant with the realm of the possibilities available because of technology.

**The Changing Real Estate Brokerage Industry**

The world of the REALTOR® is changing. Technological innovations are accelerating at a rapid pace. With the advent of integrated technologies, voice, data and video, traditional delivery of real estate information is being replaced with new services. In many cases, these new technological applications to real estate data offer an efficient, cost effective and highly organized exchange of information. Let's take a simple example -- nothing fancy required -- just a touch tone phone and $5.95 and home buyers and sellers can access the Home Price Line and get all the most recent sales on their street or neighborhood thereby establishing with a fair amount of accuracy the current value of their home. Of course, they can get the same service from a REALTOR® should they choose, but the technology is in place to do it themselves.[2]

At least at this juncture, consumers believe there is value added in using a real estate licensee to gather and evaluate information about real estate markets. According to a recent NAR publication, most consumers believe real estate agents provide important and useful services. Over three quarters (78 percent) agree that agents can show them a better selection of homes than they could find on their own. Almost three quarters (74%) agree an agent saves time, and 70 percent agree an agent makes buying/selling much easier. On a less favorable level, more than half (57 %) of those surveyed feel that agents are preoccupied with making money rather than serving consumer needs. Intuitively, one can conclude that as consumers become increasingly familiar with cost effective technology that allows them to access and evaluate information more easily, real estate brokers and agents are going to have to enhance the unique services they can bring to buyers and sellers just to preserve consumer belief that the services of a real estate broker are needed.

**Business Activity of Firms**

Real estate brokerage, especially residential brokerage, will continue to be the most important revenue producer for real estate companies in the future. That is not to say that broker/owners will not offer other real estate services, like CLO, but these additional services are not expected to provide more revenue than brokerage services enhanced by computer technology. Nevertheless, it is critical that real estate firms be allowed to provide a full range of real estate-

related services. The average profitability of residential brokerage companies has fallen in recent Income, Expense and Profits Studies conducted by the Association. As business costs continue to escalate, real estate firms will be required to achieve profitability through cost containment and diversification.[3]

**Technology and the Multiple Listing Service (MLS)**

Computerized Multiple Listing Services (MLS) changed traditional brokerage business practices, converting closely held real estate listing information into readily available business data, accessible by all REALTOR® members. Emerging telecommunication systems coupled with rapid assimilation of personal computers by American households presents both challenges and opportunity: the challenge to stay current as the comprehensive source of real estate information and new opportunities to provide easier access to that information. Currently, the MLS is the prime source of property information for REALTORS®; however, competitive market forces are introducing substitute systems that draw on broader technological capabilities, including multimedia and interactive touch screen features to take advantage of real estate information databases. The 1990s will witness the complete networking of the business world with consumers; the critical issue facing the real estate industry is adopting technological change while concurrently benefiting both real estate professionals and consumers.[4] Technology is rapidly facilitating the home search process in other ways. MLS listing databases can incorporate Geographic Information Systems (GIS) to include area maps and specific house locations. MLSs now utilizing GIS include Puget Sound (Washington) Multiple Listing Association, Newport-Mesa (California) Board of REALTORS®, and the San Fernando (California) Board of REALTORS®. Working with a REALTOR® through the MLS, customers geographically compare house locations with community facilities, employment centers and other specified sites.

**MLS as a Networked Telecommunications System**

In its traditional configuration, MLS is a stand alone main frame computer operated and housed in a board office or separate board/private MLS location; no two MLS systems are connected or talk to each other. The new telecommunications approach allows information to be distributed across and between networks; MLS delivery in the future could offer integrated real estate information databases throughout large geographic regions as well as across the country, if desired. The State Associations of Vermont and Maine are currently investigating a new information and delivery system offered by NYNEX, the New England regional phone company. The jointly controlled/owned MLS database, as well as other computerized Board functions, are distributed from a centralized NYNEX computer located in the New York metropolitan area. With a fully networked NYNEX local distribution system, system access is treated as a local calling area. Local MLS systems join the state wide system but continue to control access to the database and manage the overall system.

The rapid development of new transmission technologies such as fiber optics, video dial tone and digital switching creates a multimedia MLS system capable of offering many more services to real estate professionals and their clients and customers. The Central Maryland MLS has started a brand new service employing networked technologies to assist Commercial and Investment (C&I). Through an independent subsidiary of the MLS, Atlantic Systems and

Programming, C&I subscribers who are REALTOR® board members can hook into a number of real estate related databases. These databases include public records, such as property transfers, tax records, building permit information as well as census data and a computerized mapping option; the system also includes an e-mail feature for subscribers to communicate with each other about their properties. Networks can turn MLS systems into information shopping malls of real estate information.

These new approaches to real estate information are quickly transforming how consumers receive real estate information including home sales availability, the characteristics of the home and supporting real estate transaction information. At the same time, these technological changes have the potential to alter the traditionally accepted business relationship between brokers/agents and home sellers and buyers. Technological innovation could set the stage for new definitions of the role of and the services offered by real estate practitioners of the future.

The competitive business climate of the 1990s and the more rapid integration of technology in everyday activities, may well catapult these systems to full industry penetration by the end of the decade. Each system discussed here is offering a new approach to real estate information access and dissemination, pivotal elements in the selling and buying of real estate. These systems are stand alone information databases that currently operate in addition to established MLS systems in respective real estate markets. In the majority of cases, real estate brokers or their agents are a key source of the information but not in all cases. They are relevant to this discussion because they reflect the dramatic nature of the changes affecting the real estate industry at all levels. Opponents of HUD's rule would like you to believe that there is no need to adapt to what is essentially a new world. In the past, consumers were forced to accept the inefficiencies of a paper intensive mortgage process. Today, they know that there are alternatives. There is no turning back.

The following examples are but a sampling of what is out there and are primarily targeted at the residential real estate market. Commercially oriented systems do exist but they are less likely to be open to users beyond the members of a particular commercial real estate organization.

**HomeView - A Realty Search Service**

Introduction

HomeView is a real estate brokerage company located in Needham, Massachusetts utilizing interactive, touch technology to present prospective home buyers information on houses for sale in the Boston metropolitan area. The business is structured as a broker membership company. Broker membership is free and carries with it the right to input a broker's listing information into the company's computerized information system. Broker members are required to sign a contractual agreement with HomeView that all buyers that are introduced to a house through the HomeView system will be considered HomeView customers. If a sale occurs, HomeView will receive from the member broker a negotiated portion of the final sales commission similar to a cooperating broker fee.

By mid 1993, HomeView broker members number over 400 small to mid-sized brokerage firms in the Boston area. Currently, HomeView has three office locations in the Boston area as well

as 13 kiosk locations, including kiosks at Logan Airport and in the Boston subway system. In the Boston market, HomeView estimates that approximately 1700 realty firms represent the majority of listings in the Greater Boston Board of REALTORS®. These are the firms targeted by HomeView to be broker members of their system.

The exclusive interactive, touch screen technology used by HomeView was designed by the company founder, Bob Norton. Mr. Norton has an extensive background in technology applications but no real estate background, other than the purchase of his own house. Essentially, Mr. Norton postulated that technology could substitute as the selling sales associate and successfully out compete other selling agents, particularly in a market place in which 70 percent of the transactions are co-brokered.

The HomeView system relies on the integration of computerized data base technology with the addition of information visualization and touch screen features. The imaging technology uses photographs as its basic picture. The screen can be touched to make initial selections about house criteria such as neighborhood, bedrooms and other amenities; the program can filter essential selection criteria, such as no pool from desired items. Once buyers input their criteria, the program selects all the matching listings.

The computer screen then becomes a window on the house; the system displays front yard and back yard views plus views of up to 7 rooms in the house. Additional features of the system include a geographic program to pinpoint specific street locations of selected homes as well as area maps to highlight the general house location in the town and the distance to Boston. The system can also compare rooms of two houses on the screen simultaneously. Buyers can do room to room comparison shopping without committing all the room details to memory.

HomeView represents sophisticated use of technology applied to the real estate business. It has been up and running since late 1991; in September, 1992 an equity position in HomeView was acquired by IBM. Prior to IBM's investment, HomeView literature cites approximately 5 million in start-up costs. Currently brokers and buyers use the system free of charge and HomeView participates in the selling side of the commission.

HomeView attracts prospective home buyers through kiosk locations, T.V., radio, billboard and print advertising. To recoup initial investment, HomeView needs to pursue dual strategies of capturing a majority of home buyers in the Boston target market and to prepare a franchising expansion plan on a national scale.

The current HomeView strategy works well in a real estate market such as the Boston metropolitan area where cooperating brokerage predominates. However, in real estate markets where listing brokerage firms also capture a high percentage of the selling side transactions, HomeView may find it more difficult to compete.

In its capacity as a brokerage firm, HomeView has recently joined the majority of Boards of REALTORS® in the Boston area in order to have access to non-member broker listings. With its distinct combination of technology and brokerage services, HomeView represents one model of state of the art real estate practice.

**Home-Link**

Home-Link is a computerized 1-800, touch-tone phone system that faxes listing information to a caller. The system creator is William Raveis, Broker/Owner REALTOR® of William Raveis Real Estate in Fairfield, Connecticut, the largest independent real estate firm in the State of Connecticut. The system is currently used only for William Raveis Real Estate listings; however, it is the company's intent to market the system to other real estate firms throughout the country and in Canada. Listing agents pay the cost of the entry through an input subscription fee plus the cost of each incoming call requesting information. Agents receive the immediate benefit of warm prospects who are interested in their listings.

The system was introduced in January, 1992 and has resulted in substantial productivity improvement. William Raveis Real Estate secured 500 exclusive corporate relocation listings attributable to the introduction of the system. In addition, Mr. Raveis credits the system with reducing the time on market from the area average of 150 days to 51 days for homes in the Home-Link system.

One important operating premise is that fax on demand is perceived as a value added service by both sellers and sales agents. The value added aspect of the system therefore justifies charges to the agents to input into their company system and to the seller through a higher sales commission.

Home-Link utilizes the simple linkage of computers to telephone lines to access data then transmit the data by fax. The system required writing a personalized program to meet the specific parameters set forth by William Raveis Real Estate, exclusive owner of the system. The Home-Link computer sorts the listing data base by the callers criteria, sends the information to the caller and creates a daily log of all callers, including name, address, phone number and specific information requested. The agents are quickly relayed new prospects and immediately institute follow-up calls.

As designed Home-Link emphasizes the use of technology to foster direct contact between buyers and the LISTING FIRM. The computer acts as a surrogate for the listing broker/agent. Through the computer, buyers interact directly only with the listing broker/agent to learn for sale information, thus bypassing referral networks and possibly eliminating the need for a cooperating broker. Also the buyer self selects many of the features of the desired home, thus shortening or eliminating the time consuming task of matching buyer needs with available products.
In addition to Home-Link, William Raveis REALTORS® has given 1000 agents laptop computers. The laptop computers have contact management software installed, are programmed to perform Comparative Market Analysis (CMA), and contain a complete daily updated MLS listing database. Raveis REALTORS® is one of the first major brokerage firms in the Northeast to incorporate extensive technology into their daily business practice.

**CompuHome**

CompuHome is offered exclusively by Grempler Realty, Inc., a Baltimore, Maryland real estate firm with 17 offices and 1,000 agents. At the present time, Grempler Realty, Inc. has one other real estate brokerage firm that subscribes to the system. CompuHome is an online, menu driven computerized bulletin board service available to anyone with a computer and modem. In addition

to providing comprehensive listing information, the system also provides information on current mortgage interest rates, a sellers' net sheet program that computes expected net proceeds from the sale, an open house schedule and related real estate business topics, such as education courses.

CompuHome is a straightforward use of phone lines and computers. Grempler Realty, Inc. which began computerizing real estate information in 1968, has an extensive database program accessible to anyone calling their computer. The computer technology utilized by Home-Link and CompuHome is virtually identical; the difference is that CompuHome users access information from computer terminals while Home-Link users obtain information across phone lines to a fax machine rather than computer screen. It is true that users of the CompuHome service are more likely computer literate and comfortable with an interactive computer environment while callers to Home-Link need only know how to dial a touch-tone phone and listen to directions.

Grempler's CompuHome system offers a relatively low cost alternative for brokerage firms to enter the world of high technology. Grempler Realty, Inc. must bear the cost of designing a user friendly program but in many respects, it is a very cost effective extension of their own in-house listing data base. Modem users pay any cost associated with the phone call and printing of the information off their printer.

Perhaps, the real key to Grempler's system is that it is more than a listing information service. Since it utilizes computer to computer communication, it can provide a variety of information to the prospective home buyer on their computer screen, including detailed financial information on each house right down to the monthly payment. Important information can be selected by the caller to be printed at their computer terminal.

**Virtual Reality**

A technology which is actively being researched, virtual reality extends multimedia to an even greater interaction with the human senses, including touch and smell. Current versions often involve wearing a special helmet which covers your eyes and, for example, changes what you see as you turn your head. Using this technology, it may be possible for a buyer to "tour" a home without ever leaving the broker's office.

These systems represent some of the advances in the field of real estate information services. It is a finite list and does not pretend to include either all systems or all technologies that already exist or are about to be introduced to the marketplace. They represent new technologies offered to the real estate community and the home selling or home buying consumer; their impact on the practice of real estate in the future is yet to unfold. What is known is that technology's impact on the real estate industry is here today and will be an even more significant aspect of the practice of real estate in the future.[5] A recent article in the Washington Post is included on virtual reality as an attachment to the testimony.[6]

**The Evolution of the Mortgage Delivery System -Computerized Loan Origination**

A computerized loan origination system (CLO) involves the placement of a computer terminal in a broker's office. It provides information about the loan products offered by one or more lenders. It can also be used to pre-qualify borrowers and transmit mortgage applications. Buyers are

assisted in the application process by the system operator. Today, there are a few national systems, but as the technology becomes less costly, regional and local systems will emerge tailored to the specific needs of individual real estate markets. The CLO systems of the future will be open to as many lenders as the system can accommodate, which essentially is unlimited. The only reason for excluding lenders will remain negative experiences with a lender's performance during the funding process or in the servicing of the mortgage loans.

The market development of CLO systems is similar to the development of Automated Teller Machines (ATMs). In the early stages of the ATM market, several area banks started independent systems which only the bank's customers could access. In a short time, the area banks entered into joint ventures or agreements with other area banks so that a bank's customers could use any ATM in the system, not just the ATM machines operated at the customer's bank. If the market for CLO systems is permitted to take a natural evolutionary process, we believe the same multi-institution access will develop.

Computerized loan origination systems extend the concept of multiple listing services for houses to the realm of mortgage finance. They forge new links between home buyers and mortgage originators. They enable real estate brokers and their agents to keep up with the literally hundreds of basic combinations of loans available to fulfill the needs of their clients and customers. This information can be changed instantaneously in response to minute-to-minute changes in the mortgage markets which lenders must make to remain competitive. This is a far cry from "the old days" when mortgage lending rates and products were fairly standard for months and years at a time.

CLO systems provide rural areas served by one, perhaps two, financial institutions with the mortgage products of national lenders, bringing much needed competition to these markets and increased choices for consumers. They are also useful during periods of high interest rates when lenders are less willing to negotiate mortgage rates and, in fact, withdraw from certain markets altogether. This was the experience in Ohio, where the CLO system developed by the Ohio Association of REALTORS® in the early 1980s increased mortgage competition and lowered rates.

Computerization enables lenders to turn around loan applications in as little as a few days when the average time a homebuyer waits for a decision on a loan processed manually is more than 30 days. The introduction of streamlined processing has forced all lenders to improve upon their turn-around time. For consumers, for whom a simple, fast process is of tantamount importance, the "coming of age" of the mortgage delivery system has been long overdue. Streamlined processing lowers transactional costs of obtaining a mortgage through reduced points, fees, interest rates, or some combination of these. A reduction of a quarter point in these transaction costs, which is a reasonable estimate of consumer savings, translates into approximately $6,000 over the life of the loan.

## CONSUMER BENEFITS THROUGH REALTOR® INVOLVEMENT IN CLO SYSTEMS

The list of benefits to consumers as a result of the computerization of the mortgage process is extensive:

- o Real estate brokers and agents who use CLO systems can create competition among lenders. CLO systems allow real estate brokers to access mortgage markets outside their own geographic area. Local lenders are forced to compete with national lenders which can mean lower mortgage rates for consumers.

- o Consumers benefit from the efficiencies of a computerized mortgage process. Streamlining the process has forced all lenders to accelerate the application process in order to remain competitive. Being able to receive quicker commitments from lenders relieves a considerable amount of the stress consumers normally experience with the mortgage process. Speed of processing enables real estate licensees to take the information necessary for the mortgage application, input it into the computer and immediately transmit it to the lender.

- o CLO systems provide borrowers with up-to-date information on interest rates and programs of various loan products. Unlike rate sheets, which may be provided weekly, the CLO can provide up-to-the minute and accurate information.

- o If the buyer does not obtain a mortgage commitment from the lending institution to which he initially applies, under a CLO, he is more likely to be able to submit a second application within the mortgage commitment time period without forfeiting the sale.

- o Under many CLO systems, the buyer can submit applications to multiple lenders simultaneously thereby increasing the odds of receiving a commitment.

- o CLO systems decrease the cost of the mortgage application process through economies of scale. Uniform application forms result in a time savings in filling out forms and multiple applications can be generated at a lower cost than is possible filing separate applications.
- o CLO systems enable real estate brokers to track the mortgage application more readily.

- o CLO systems may be able to reduce lender bias. Computers cannot determine race, creed or color. It would be quite difficult for a lender to practice discrimination observing computer generated data.

<u>Perhaps the greatest consumer benefit of having a REALTOR® assist in mortgage origination is that the cost of these services is often less than the cost incurred when a mortgage broker charges for these same services.</u> Typically, a mortgage broker will receive one-half of a point. Further, the amount varies depending upon the type of mortgage loan he sells. Consumers are rarely informed that there is a difference in the amount a mortgage broker receives, a fact that may influence the types of mortgage product being offered.

**RESPA and Controlled Business Arrangements (CBAs)**

In 1983, Congress amended RESPA by adding provisions dealing with "controlled business arrangements". A legislative history prepared by the NATIONAL ASSOCIATION OF REALTORS® is included as an attachment to NAR's testimony.[7] After much deliberation, Congress passed legislation that, while not favoring CBAs, did acknowledge the potential consumer benefits to be

gained by the economies of scale offered by diversified financial services firms. HUD's rule conforms to Congressional intent in that discounts for bundled services are permitted for consumers who choose to use affiliated providers of settlement services. Of course, the basic premise of the original legislation is upheld -- full written disclosure of the affiliation and charges associated with the services to be rendered and the consumer is free to choose any provider of a particular settlement service. While this provision is typically portrayed as benefiting large firms rather than small businesses, a significant number of "Mom and Pop" shops benefit because of the 1% ownership threshold set by Congress in 1983. There are countless REALTORS®, mortgage brokers, and insurance agents who can join forces and compete with the "big guys" by delivering personal service at a competitive price. As we speak, these alliances are being formed. After all, who knows a local customer base best -- a real estate firm or mortgage banker who operates as an integral part of the community or a national corporation?

We would urge those who are protesting that they are being squeezed out of the market by larger firms to trade on their strengths and the personal and professional network that has served them so effectively. There are anti-trust laws to curb monopoly abuse. Let these serve as the "watchdog" for the industry.

## NATIONAL ASSOCIATION OF REALTORS® DEVELOPMENT OF RESPA POLICY

### Background

In September of 1988, NAR President Nestor Weigand appointed the Real Estate Settlement Procedures Act (RESPA) Task Force to examine the issues raised by the proliferation of loan 1eferral arrangements, computerized loan origination systems, controlled business arrangements and other questions raised by the RESPA regulations.

At the time NATIONAL ASSOCIATION OF REALTORS® had policy on RESPA as follows:

"That the NATIONAL ASSOCIATION OF REALTORS® oppose all legislative and regulatory efforts to prohibit or limit the payment of additional compensation for real estate-related services accorded buyers and sellers, including mortgage finance, insurance and other related items, provided such compensation is fully disclosed to the buyer and seller."

This policy supported the payment of fees for real estate related services provided that all such fees are made known to and accepted by the customer prior to settlement. NAR's policy was of long-standing, however, and, needless to say, was being challenged by market arrangements that did not exist at the time of its formulation. In light of new forms of prequalification, point of sale financing and the relationship of some members with national programs like Citicorp Mortgage Power, the Task Force was asked to consider what corrections, modifications or other changes need to be made in Association policy on RESPA. These recommendations were to be made within the context of currently proposed regulations, pending legal actions and potential legislation.

Key to the task force discussions was HUD's language in the May, 1988 rule permitting payments for "bringing the borrower and lender together". There was concern that these could be construed as "naked" or "simple" referral fees. The goal was to clarify NAR policy about fees

received for participation in national loan programs and payment for referrals within controlled business arrangements.

Task Force Conclusions

(1) The Task Force concluded that computerized loan origination programs which allow real estate brokers/agents to provide homebuyers with mortgage-related services are a positive development for all parties concerned. They enable real estate brokers to provide consumers with point of sale financing at what is often a cost savings for consumers. Fees charged for CLO services offset costs incurred by brokers for installing and operating the systems. If real estate agents receive fees in connection with a lender program, they must be based on actual work performed for the borrower rather than the referral of the borrower's business.

(2) Within controlled business arrangements, as statutorily defined, the Task Force upheld its policy recommendation in opposition to payment for simple referrals within this corporate structure.

The Final Policy

Adopted by the Board of Directors, February 6, 1989:

> Where a real estate broker/agent provides services in addition to or different from those he/she is obligated to provide by his/her agency agreement, that broker/agent is entitled to remuneration for these services, provided that full and written disclosure is made to and accepted by all clients and customers to the transaction in advance of undertaking to perform such services. The NATIONAL ASSOCIATION OF REALTORS® is opposed to the acceptance of fees by real estate brokers/agents for the simple referral of customers or clients to mortgage lenders and providers of other settlement related services. (emphasis added)

In controlled business arrangements, as defined by the RESPA statute, the NATIONAL ASSOCIATION OF REALTORS® believes that brokers/agents are entitled to remuneration for the delivery of real estate related services provided that written disclosure (which is not unduly burdensome) is made to and accepted by all clients and customers to the transaction; and there is no required use of these services.

The NATIONAL ASSOCIATION OF REALTORS® is opposed to legislative or regulatory efforts to limit the payment of remuneration for these additional services.

**Legislative/Regulatory Changes Needed**

The NATIONAL ASSOCIATION OF REALTORS® does not support further legislative changes to RESPA but would recommend some clarification at the regulatory level. Specifically, it would be helpful to add definitions of computerized loan origination and a bona fide employee. We believe this would end some of the controversy surrounding referral fees to independent contractors and additional fees for computer information services that are typically provided free of charge by brokers/agents representing sellers. NAR would be happy to work with HUD to develop these



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definitions. We would also be willing to prepare compliance materials (seminars, pamphlets) for REALTORS®. We have included the RESPA Compliance Kit distributed at NAR's Legislative Meetings as an attachment to the testimony.[8]

**Conclusion**

Mr. Chairman, the real estate industry is growing and requires a revolution in mortgage lending to handle that growth. By the year 2001, there will be a demand for $1.4 trillion in mortgage money. Seven to ten million more people will be buying homes. The preferences of these home buyers will also increase the need for alternative mortgages and for real estate brokers/agents who can take the buyer quickly and knowledgeably through every step of the real estate transaction.

In our view, we can no longer afford to put a stranglehold on the mortgage delivery system because of an "alleged" turf war between competing interests. I say "alleged" because the very members who make up some of the trade associations opposing this rule have already moved ahead. Consider the program of a mortgage banker in Portland, Maine (see attachment). In this case, an independent mortgage banker has employed a staff of real estate licensees to represent consumers who are interested in purchasing a home and financing it through this particular company. The real estate agents are buyer brokers and paid by the lender. A second attachment offers a real life example of a diversified financial company that offers a complete array of financial services and products. It is perfectly legal -- all federal and state licensing laws have been met, and it could be the prototype for the future. Incidentally, this is a small business where the firm has a limited number of independent contractors in each of the service areas (13) who each bring a client base of 200 individuals to the corporation.

Denial of the inevitable can be deadly. We have spent too much time fighting each other when we should be joining forces to bring the real estate industry into the 21st Century.

Thank you for the opportunity to address the Committee. I will be happy to answer any questions you may have.

Endnotes:

1 The NATIONAL ASSOCIATION OF REALTORS®. Real Estate Horizons: A Look to the 21st Century. January, 1992. Page 9-4

2 Vandevanter, Peter. "Guide to the Home Price Line". the Washington Times. June 18, 1993. Pages H23-26.

3 The NATIONAL ASSOCIATION OF REALTORS®. Real Estate Horizons: A Look to the 21st Century. January, 1992. Chapter 9

5 Meany, Cole, Deem, Reed and Wallis: "Technology in the Real Estate Business: Future Trends & Policy". April, 1993

5 Lehman, H. Jane. "REALTORS® Grip on Home Data in Danger". The Washington Post. June 26, 1993. Pages E1/E8, Col. 1

6 Lehman, H. Jane. "Virtual Reality Systems May Revolutionalize Search". The Washington Post. June 26, 1993. Page E8

7 Gallagher, Henry T. "Real Estate Procedures & Controlled Business Arrangements". 1991. Pages 1-25

8 The NATIONAL ASSOCIATION OF REALTORS®. "Real Estate Settlement Procedures Act Compliance Kit". April, 1993

FRIDAY Home Guide
# HOME PRICE LINE
SPECIAL SECTION OF THE WASHINGTON TIMES

# Now you can find home sales for 5 years with a simple call

> "You should regularly check the value of your biggest single investment."
> — *Rufus S. Lusk III*

By Peter Vandevanter
THE WASHINGTON TIMES

When was the last time that you figured — not guessed — the value of your home? I know you carry a guess about its value the way you carry around pictures of your children or your pet or your significant other or — egads! — pictures of your sisters or brothers or parents — somebody I hope. In other words some sort of perceived value of your house is standard mental baggage.

But could you go to the bank with this guess about the value of your home?

Probably not. It's probably not very accurate. Your neighborhood is subject to so many changes, from overall market effects to particular labor changes.

Your guess as to the value of your property is probably 10 percent more or 10 percent less than the amount the last property you heard about sold for depending on whether your house is bigger or smaller than that house. Right?

Do you realize that a house appraisal – which is a report written by experts analyzing the value of a house – is considered out of date after six months? That's how quickly things change when you get down to the one-house, one-neighborhood level.

Perhaps your guess as to the value of your property is slightly more or slightly less than what you paid for it.

Not good enough.

"Most investors will check their stocks and mutual funds at least weekly," says Rufus S. Lusk III. "But few check on the value of their largest investment, their home. Homeowners really should find out what homes in their neighborhood are selling for twice a year. You should regularly check on the value of your biggest single investment."

Good advice.

And now the Friday Home Guide (in partnership with Rufus S. Lusk & Sons Inc., a real estate data-base company based in Silver Spring) is giving you a way of doing just that. The Home Price Line.

That's right, starting today, you can call the Home Price Line and for $5.95, charged to your credit card (Mastercard, Visa or American Express), you can get all the most recent sales on your street or in your neighborhood and thereby establish fairly accurately the current value of your house.

Now let me say here very clearly. Any Realtor could perform this same service and probably for free. So if you want to save $5.95, call a Realtor.

If that's not right for you, permit me to demonstrate. I'll use three examples, because this telephonic database is set up with three prompts, offering three different types of services.

## Application 1:
### Finding the sales price of a specific house

Let's say you want to put a contract on a house, but you're not sure how much to offer. A natural question is: Well, how much did the current owner pay for the house?

If the current owner bought the house within the past five years you can use the Home Price Line to find out the sales price. (Or you can ask a Realtor to get the number for you – just a reminder.)

To demonstrate let's check 909 C St. SE on Capitol Hill (which as far as I know is NOT for sale currently, this is just chosen as an example.)

First you would call 800/788-4444.

The voice asks for the first five letters of the town you are interested in. You punch in WASHI. The voice tells you "Washington" and asks for confirmation. You punch 1, for confirmation.

Next the voice asks for the street. You punch in C (key 2).

Because the 2 key represents A-B-and-C, the voice comes back and asks if you mean "A?" You say no (punch key 2). "B?" No (punch key 2). "C?" Yes (punch key 1).

Next the voice asks for a quadrant. You punch SE (the 7 and 3 keys).

Next the voice asks for the address. You punch 9-0-9.

Then the voice begins searching, saying, "Searching 1993. Searching 1992. Yes," the voice says, "the property sold in 1992 for $173,000."

Then the voice asks if you want to keep searching. You say yes (punch the 1 key).

"Searching 1991," the voice says. "Searching 1990. Searching 1989. Searching 1988. Yes," the voice says, "the property sold for $170,000 in 1988."

Ureka. Two sales in five years. It appears that someone bought the town house for $170,000 in 1988 and sold it to the current owner for $173,000 in 1992.

That's exactly what you needed to know. Those are two big clues as to the market value of the property. And those clues will help you fashion an offer.

## Application 2:
### Searching whole streets for sales histories

This is the application that I found the most fascinating. Having just moved into a new neighborhood, I was very eager to run the numbers on all the houses and go around looking and comparing.

The street I moved into was Mosby Street in Alexandria. When I called and asked for the sales, the Home Price Line gave me 11 sales in the past five years: January 1993, 2811 Mosby St., $135,000; March 1993, 2706 Mosby St., $166,000; April 1992, 2800 Mosby St., $150,000 ... $85,000 ... $96,000 ... $133,000 ... $118,000 ... $144,000 ... $50,000 ... $33,000 ... $120,000.

The next street down the hill, which runs parallel to mine is Holly Street. Next, I ran those numbers: April 1993, 3104 Holly St., $245,000; April 1993, 3407 Holly St., $424,000; March 1992, 3106 Holley St., $277,000 ... $440,000 ... $433,000 ... $433,000 ... $402,000 ... $270,000 ... $626,000 ... $525,000 ... $540,000 ... $523,000.

Let's say I was mildly shocked by these numbers.

The difference in prices between the two streets was shocking. After all, they were all houses built in the 1920s.

Granted, Holly Street has larger, better renovated houses. But

see PRICE LINE, page H26

From the desk of
**PETER VANDEVANTER**
Editor, Friday Home Guide

Date: June 18, 1993

Dear Home Buyer and Home Seller:

Welcome to the Home Price Line.
This is meant to be another tool for you. Maybe you'll never use this new ser-
vice, which costs $5.95 per phone call. But you should know it's there.
You should know that the Friday Home Guide is trying to help you with as many
of the details of the real estate process as possible. The information on the Home
Price Line is available from any Realtor. So don't overlook the opportunity to talk
to a Realtor about this subject.
However, from my observation, the modern consumer likes to know as much as
possible about everything, even if he or she is going to use an expert to get some-
thing done in the end. That's just the nature of being an American consumer in the
1990s.
If a doctor tells you that you have bursitis, you go to the library and look up
everything you can about the problem. If the dentist tells you to floss, you inves-
tigate gum disease. If you decide to put a deck on your house, you research decks
before you call a contractor.
And this is very similar.
Understanding real estate is almost a necessity to partake in the process. That
doesn't mean you don't use experts when the fateful day arrives when you actu-
ally put a contract on a house, or the fateful day arrives when you put your house
on the market.
But until those moments arrive, information from any and every source should
be sought.
Here's a fun new tool. It has the potential of saving you thousands of dollars,
either in deciding what price to offer to buy a house, in the pricing of your house
for sale or on your tax assessment.
I've been using it about three weeks in preparation for this launch. In this spe-
cial section, I describe some of the uses and give you as many hints as possible to
make the expenditure of your money as valuable as possible.
Whatever you decide to do, please call me and tell me what you think. I welcome
questions and comments about this new service.
My number is 202/636-3265.

## TO ACCESS
Call 800/788-4444

## ON-LINE HELP
If you have a problem getting the house record you want, call 800/793-0852.

Guide to the Home Price Line

# What to expect when you call the price line

## Be prepared

For your $5.95 phone call you will be able to do about four or five specific house searches or get 10 sales by street searches or about 15 addresses by searching price.

So do your homework.

Make sure you have a pen and paper in hand. When the voice reads the addresses, you won't be able to visualize the houses and remember the dates and prices fast enough.

So you'll want to just take dictation and then review the list later when you don't have one ear on the phone.

## No, it's not the phone lines

We apologize for the sound of the synthesized voice that reads most of the addresses. The database is being updated using the female voice that you hear when you first come on the system.

## When in doubt, wait

Whenever you are listening to directions and you wonder whether you can go ahead and push a key rather than wait until the end of the message – just wait.

The voice doesn't say you have to wait for the beep, but you do.

If you don't, sometimes it just doesn't record what you have requested and you have to do it again.

## Hint, hint

If you are looking for all the sales prices on a given street, don't necessarily choose #2, which requires you to specify a block. Think about it for a second. Let's say the street you want has three or four blocks to it. How many houses do you think have sold in the past five years? Probably only 10 or so. So you can ask for the universal search without worrying about getting too many.

The system is set up so that if you ask for the universal search and the answer has more than eight sales, the voice will come back and ask you to specify the block. So you don't really have to specify the block first time out. Wait to be asked. It's easier.

## Rounding numbers

All of the prices that are listed have been rounded to the nearest $1,000.

In other words, $162,500 has become $163,000. However, $162,499 has become $162,000.

## Don't volunteer extra letters

When asked for the first five letters of a town or street, don't type any more than that. If you type six letters, the voice will come back and tell you that the area you are looking for is not recognizable.

It's an easy mistake to make if you aren't careful to type A-L-E-X-A-N for Alexandria when you should only type A-L-E-X-A.

## Call again

If you want to get more searches than you accomplish in the five-minute time limit, you will have to hang up and call back. This is meant to protect you from accidentally running up a larger than expected phone bill.

## Most common mistakes

Here are the most common mistakes, according to INPHO, which has used this system in the Boston area for more than a year.

1) The caller is using a pulse tone phone rather than a Touch-tone phone.

You must use a Touch-Tone phone.

2) The caller is requesting an area that is not on the approved list. Please check the list below to make sure the area you want to search is in the data base before you first dial in.

3) The street address the caller is searching for is not in the data base because the full address was not recorded at the courthouse on settlement day as it should have been.

The data base is taken from courthouse records by Rufus S. Lusk & Sons Inc., a Silver Spring-based real estate data base company.

**FOR HELP, CALL 1-800/793-0852**

**If you call between 8 a.m. and 6 p.m., a person will field the call to answer your question or finish the data base search for you.**

**If you call at any other time, you can leave your name and telephone number and a representative will call you back the next working day.**

**INPHO, which is the Boston-based company whose technology makes the Home Price Line possible, is interested in discovering the bugs in the system and getting your impressions on the product. The company believes that if you paid your money, you deserve the information.**

# Areas you can phone-search by name

## Make sure you match your area of interest

A list of the areas available for database searches on the Home Price Line. In other words, when the operator asks you for the first five letters of the area you wish to search, here is a complete list of all the areas that are available for you.

Before you call you should look down this list.

For instance West Springfield is not on the list. The question is what geographic area surrounds West Springfield. Yes, Springfield. And that is on the list. So if you want to search West Springfield, type in "SPRIN" for Springfield. The voice will specify in the answers whether the property is in Springfield or West Springfield.

Or maybe you want to search Arlandria. That is not on the list either. But Arlandria is a part of Alexandria. So you should type in "ALEXA" for Alexandria.

Accokeek, Md.
Adelphi, Md.
Alexandria, Va.
Annandale, Va
Annapolis, Md.
Annapolis Junction, Md
Aquasco, Md.
Arlington, Va.
Arnold, Md.
Ashton, Md.
Baltimore, Md.
Barnesville, Md
Beallsville, Md
Beltsville, Md.
Bethesda, Md
Bladensburg, Md
Bowie, Md
Boyds, Md
Brandywine, Md
Brentwood, Md
Brinklow, Md
Brookeville, Md
Burke, Va
Burtonsville, Md
Cabin John, Md
Capitol Heights, Md
Catharpin, Va
Centreville, Va
Chantilly, Va
Cheltenham, Md
Cheverly, Md
Chevy Chase, Md
Churchton, Md
Clarksburg, Md.
Clifton, Va.
Clinton, Md
Colesville, Md
College Park, Md
Crofton, Md.
Crownsville, Md.
Damascus, Md
Davidsonville, Md
Deale, Md
Derwood, Md
Dickerson, Md
District Heights, Md
Dunkirk, Md
Dunn Loring, Md
Edgewater, Md
Fairfax, Va
Fairfax Station, Va
Falls Church, Va
Fort Belvoir, Va
Fort Meade, Md
Fort Washington, Md
Friendship, Md.
Gaithersburg, Md
Galesville, Md
Gambrills, Md
Garrett Park, Md
Germantown, Md
Gibson Island, Md
Glen Burnie, Md
Glen Echo, Md
Glenn Dale, Md
Great Falls, Va
Greenbelt, Md
Hanover, Md
Harmans, Md
Harwood, Md
Herndon, Va
Hyattsville, Md
Jessup, Md.
Kensington, Md
Kropper, Md
Landover, Md
Lanham, Md.
Laurel, Md.
Linthicum, Md
Lorton, Va
Lothian, Md
Mayo, Md
McLean, Va
Merrifield, Va
Millersville, Md
Mitchellville, Md
Mount Rainier, Md
Newington, Va
North Beach, Md
Oakton, Va
Odenton, Md
Olney, Md
Owings, Md
Oxon Hill, Md.
Pasadena, Md
Poolesville, Md
Potomac, Md
Reston, Va
Reston, Va
Riva, Md
Riverdale, Md
Rockville, Md.
Sandy Spring, Md
Severn, Md
Severna Park, Md
Shadyside, Md
Sherwood Forest, Md
Silver Spring, Md
Springfield, Va
Sterling, Va
Suitland, Md
Takoma Park, Md
Temple Hills, Md
Tracys Landing, Md
Upper Marlboro, Md
Vienna, Va
Waldorf, Md
Washington, D.C.
WashingtonGrove, Md
West Bethesda, Md
West River, Md
Wheaton, Md

## Guide to the Home Price Line

# What if the house sold more than 5 years ago?

If you call the Home Price Line and the house you are seeking sold more than five years ago, you have one other option.

The Washington Times Friday Home Guide is offering, to a limited number of people, a price search that goes beyond five years.

The first 10 callers each week (starting at 10 a.m. Friday) can request the sales price, date of sale and assessed value of any house in the Washington area, no matter when it last sold.

**But remember, if you are not one of the lucky callers, you can always ask your Realtor for the information.**

Here's how it works:

**Call 202/636-3223**

First, give this information

*Your name* ______________

*Your address* ______________

*City* ______________

*State* ______________

*ZIP* ______________

*Your telephone number* ______________

*(Work):* ______________

*(Home):* ______________

**Next, leave the following information about the property:**

*Community:* ______________

***Address (Important, please spell out):***

______________

*Condo number* ______________

*City:* ______________

*State:* ______________ *ZIP Code:* ______________

**(If you know) Tell us whether it's:**

- ❑ Town house or detached home
- ❑ Approximate number of bedrooms
- ❑ Approximate square footage
- ❑ Sold within last 2 months? Or previously?

Finally, would you please tell us how you got the Home Guide: by subscription, direct mail or newsbox.

Also, what do you plan to do with the information that you receive?

Thank you.

The Washington Times will get the sale price, date of sale and assessed value for you and mail it to you.

Remember: You have to be one of the first 10 callers on Friday, starting no sooner than 10 a.m. Call 202/636-3223.

Happy hunting.

# PRICE LINE

*From page H23*

should there be such a difference in prices? The Holly Street houses averaged $200-$300,000 more.

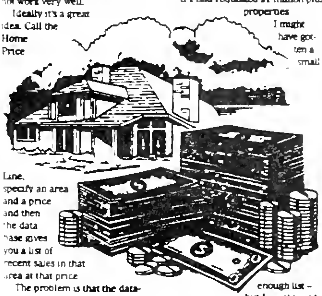
I never would have expected such a discrepancy.

Do you *really* know your neighborhood? Check it out. You might be shocked, too.

### Application 3:
### Searching areas by price

Honestly, this application does not work very well.

Ideally it's a great idea. Call the Home Price Line, specify an area and a price and then the data base gives you a list of recent sales in that area at that price.



The problem is that the database breaks up the Washington area into about 130 areas, which means that each area is still very large. To specify any price range, except those either very low or very high, will give you too many listings.

The other problem is that the synthesized voice that reads the addresses cannot be understood well enough to be able to recognize streets you've never heard of. Improvements will be made.

Here's what I tried: Alexandria, $200,000.

Out of the first 12 recent sales in Alexandria for $200,000 I could understand only three streets. And I didn't recognize those streets so at least right off the bat the search did not give me much to work with. I could have kept requesting streets but things could have gotten worse instead of better.

If I had requested $1 million plus properties I might have gotten a small enough list – but I might not be able to understand the addresses.

If you know Alexandria like the back of your hand you may understand the addresses. But, chances are, if you're trying to move into an area, you don't know the addresses. That's a classic Catch-22.

Washington Post, June 26 1993, p. E1

# Realtors' Grip on Home Data in Danger

## *Entrepreneurs Outside Industry Challenge Use of Multiple-Listing Services*

By H Jane Lehman
Special to The Washington Post

The real estate industry's lock on information about homes for sale is slipping, threatened by more technologically sophisticated ways of bringing home buyers and sellers together.

Several entrepreneurs outside the real estate field are challenging the role once filled exclusively by the multiple-listing services (MLS), computerized databases of homes for sale that are controlled by local offshoots of the National Association of Realtors (NAR).

The powerful real estate trade group is marshaling its forces to fight off the upstarts, including System of Multiple-Colored Images for Internationally Listed Estates Inc., SureFind Classifieds by Telephone and HomeView Realty Search Centers.

Regardless of whom prevails, the outcome should bring largely good news for the home buyer. The first step in the home search—eliminating unsuitable options—is destined to become easier and less time-consuming.

And the same innovations that allow buyers to narrow their searches work to sellers' advantage by exposing their properties to a wider array of purchasers, industry analysts said.

The typical home search usually starts with a buyer contacting a real estate agent to learn what properties are for sale. The agent can search the local MLS database by location, price, number of bedrooms or other features to produce a list of homes for consideration.

But such a process is outdated, said Gerald Matthews, executive vice president of the Florida Association of Realtors and head of an industry task force studying how to improve the competitive position of MLS agents.

Although no one is ever going to buy a home without first seeing it, "we can save a lot of shoe leather and tires in this country by first searching electronically," Matthews said.

A recently released NAR study found that in 1991 the average buyer spent 16 weeks and visited 19 homes before reaching a decision.

However, a series of technological innovations could radically alter the way buyers scout homes. Some companies are offering access to listing information from a home computer, by phone and fax or through kiosks located in airports or other public settings.

Other firms are encouraging buyers to narrow their search list by color computer images of homes for sale. Taken to its technological extreme, that may some day mean "touring" a home by way of a computer operation known as virtual reality.

Also within the realm of possibility are searching for homes nationwide or internationally, collecting other information pertinent to the sales transaction and checking out homes sold by owners on the same systems as homes listed by real estate agents, an idea that particularly grates on the real estate sales industry.

Meanwhile, NAR is trying to hold onto its in-

See MLS, E8, Col. 1

■ *High-tech challengers to agents providing MLS database access.* *Page E10*

# MLS Competitors Offer Buyers Information by Computer, Fax

MLS, From E1

formation franchise. Earlier this spring, NAR President William S. Chee, a Honolulu residential broker, warned association members that the organization will be cut out of the information dissemination business within the next few years.

"Even if we implemented the best of plans today, we might still be too late. I personally think we have less than a 50 percent chance" of saving NAR's hold on the information business, Chee said.

One reason so many MLS systems have failed to stay competitive in the information game, said Denver-based realty consultant Stephen H. Murray, is that the MLS operations often subsidize other local Realtor board activities. Murray said he is aware of one board, which he declined to identify, that recently siphoned off $1 million for other purposes "instead of investing in MLS improvements."

MLS turf fights leading to sharply splintered markets also contribute to the problem, Murray said. For example, a buyer searching for a home in the area bounded by Howard, Frederick, Charles and Prince William counties would have to work through seven different MLS systems.

Chee agreed that fragmentation is a problem, likening it to a "few Chihuahuas fighting over a bone, unaware that a hungry lion is coming over the hill."

Matthews, though, said he believes the NAR can strike a deal to gain the technological upper hand with a "large partner that has this as their business" without incurring great cost to the organization.

Murray also discounted the efforts of the MLS challengers, unless the companies can pour vast sums of capital into the endeavors. "Even $8 million [the amount one venture has invested to date] is not enough money to change the habits of buyers and sellers to go around the real estate community," he said.

The NAR stands to suffer substantial membership and revenue losses if it is dethroned as the primary source of for-sale information, said Thomas W. Dooley, a Chicago-based real estate consultant. "A lot of real estate agents only belong to the Realtors to get MLS access," he said.

Although Matthews said the information-sharing function represents a "major piece of our value" to NAR's members, he predicted the organization will remain viable as a provider of educational and legislative services.

The loss of the MLS information lock also could exert downward pressure on estate sales commissions, Murray said. "A broker's job consists of knowledge and personal service but no one has ever priced those two parts separately," he said.

What's more, he said, the ease with which buyers and sellers may someday find each may well deprive brokers of some business at any price. "These changes slowly but surely chip away at whatever percent of the marketplace prefer to do without an agent in the selling of their properties," he said.

Matthews agreed, but only to a point. "The value a Realtor brings is the ability to market a property, not to say here is a list of homes for sale. Or, when working with sellers, the value is knowledge of the market and how to carry off the transaction and avoid the pitfalls."

Washington Post

E8 Saturday, June 26, 1993

# Virtual Reality Systems May Revolutionize Search

Think of it as a view with a room.

That's the promise of crossing the futuristic technology known as virtual reality with the home-selling process.

Imagine experiencing the sensation of walking through a home in all its three dimensions while remaining seated at a computer screen.

Using a cursor or mouse, a prospective buyer could "walk" down the hallway of a house under consideration, turn the corner and realize the view out the living room window will not do.

Skipping to another home, the viewer could visit each room, look up to see how high the ceilings are, open a cabinet and glance behind a closed door to get some sense of storage space and perhaps decide that this one deserves a real visit.

Then it's off to cruise other candidates found in the computerized inventory of homes for sale that otherwise resembles the two-dimensional multiple-listing services underpinning the realty sales efforts in most markets today.

"A prospective buyer would get the feeling of navigating a house in a way that is not possible on videotape," said John Latta, president of 4th Wave, an Alexandria-based technology consulting organization. "The effect is they are walking through the house. They control it, not the cameraman who made a video recording."

Although the scenario sounds far-fetched, several virtual reality experts were unwilling to discount the possibility of of such a system.

"It is a future application waiting for its time," said Michael Benedikt, professor of architecture at the University of Texas at Austin and a virtual reality expert.

Latta said he is "surprised we have not seen this kind of tool emerge yet. It would be particularly useful for out-of-town buyers who could not get to homes easily, but have to make decisions quickly."

For the moment, though, no forward-thinking realty concern or technology firm has married the two, even though an MLS-like application could be accomplished without the "total immersion" of virtual reality created by suiting up the viewer in a $25,000 headset and electronic glove, said Sandra Helsel, editor of Virtual Reality Report, an industry newsletter published in Tucson.

"You can get the feeling of maneuvering in virtual reality through the window of a computer screen" of a desktop personal computer, she said.

— H. Jane Lehman

## I. THE REAL ESTATE SETTLEMENT PROCEDURES ACT OF 1974

## AND CONTROLLED BUSINESS ARRANGEMENTS

***Comment.*** *In 1983 Congress amended the Real Estate Settlement Procedures Act of 1974 (RESPA) by adding provisions dealing with "controlled business arrangements." The amendments added a definition of a "controlled business arrangement" (CBA) and then provided conditions under which it could operate without violating the anti-kickback provisions (Section 8) of RESPA. The 1983 legislative effort focused on what some CBA critics charged was a "loop hole" in the original 1974 statute, namely the use of the CBA as a means of evading the Section 8 anti-kickback provisions. Led by the American Land Title Association (ALTA), the critics first sought a complete ban on the CBA. Failing this goal, they were able to obtain, in a 1982 bill, a limitation or partial restriction on the operations of the CBA. When the 97th Congress did not act on the measure, a similar bill was introduced in the 98th Congress in 1983. However, the CBA limitation provision was struck from the committee print in exchange for additional consumer disclosure requirements. The following is a brief recitation of the legislative process which led to the 1983 amendments, with particular emphasis on the role of, and impact on, the real estate agent as one of the statutory "settlement service providers" participating within a CBA context.*

***Background***

In 1974, the Real Estate Settlement Procedures Act (RESPA) was passed by Congress to provide a degree of consumer protection to home buyers in the real estate settlement process. One of the stated objectives of the law was to eliminate what Congress found to be "unnecessarily high settlement charges caused by certain abusive practices" in the industry. In particular, Section 8 of the Act was designed to prevent kickbacks and such other payments made for referrals between various settlement service providers. Entitled "Prohibition Against Kickbacks and Unearned Fees," it expressly prohibits "any fee, kickback, or thing of value" from being paid in return for the referral of "business incident to or part of a real estate settlement service" in connection with a federally-related mortgage loan. However, in order to permit a payment to be given (or accepted) for *legitimate* work done in connection with a referral, Congress allowed for such efforts to be compensated, provided services were actually performed.

In the statute (amended in 1976), examples of such "allowable" or exempt payments appear in Section 8.[1]

*Controlled Business Arrangement (CBA)*

The focus of Section 8 of RESPA is on the referral of business by or to a service provider incident to a settlement. In the two- to three-year record of Congressional hearings on kickbacks and unearned fees leading up to the 1974 enactment, the testimony addressed the conduct of ***unrelated*** entities brought together, prior to any specific settlement transaction, solely as participants in the settlement process. Little if any attention was given to the activities of those settlement services providers who joined together to operate more than one business engaged in the process. Although this phenomenon of ownership of multiple or ancillary service providers in the settlement industry existed before the enactment of RESPA, many charged that the number of real estate broker-owned title agencies grew dramatically after RESPA — as a device to circumvent the Section 8 prohibitions. They alleged that the 1974 statute contained a loophole through which the CBAs could "internalize" the referral payment, free from scrutiny. The

[1] After 1976, the following payments in connection with a real estate settlement service were exempt under the "kickbacks and unearned fees" prohibition of Section 8:

> (I) the payment of a fee (A) to attorneys at law for services actually rendered or (B) by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance or (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, (2) the payment to any person of a bona fide salary or compensation or other payment for goods or services actually performed, or (3) payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers, or (4) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Administrator of Veteran's Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture.

egality of a Section 8 "referral" of "business incident to or part of a real estate settlement ;ervice" in the context of a *jointly-owned* or *controlled* provider came into question. Many real :state brokers who expanded their customer services by creating joint ventures, partnerships or affiliation with mortgage companies, title companies, or other real estate service providers in fact vere participating in a form of "referral" activity within and among their various combined ownership interests. Critics charged that such referrals occurring within a commonly-owned multiple service provider were subject to RESPA prohibitions on "kickbacks and unearned fees." The American Land Title Association (ALTA) argued that these arrangements simply created the same problems that were caused by outright cash kickbacks and were in effect a means of evading the statute.

In an attempt to respond to the growing debate over the CBA as a permissible entity under RESPA, HUD issued an interpretive ruling (July 1980) entitled "Effect of the Real Estate Settlement Procedures Act on Certain Practices Known as Controlled Business."[2] The regulation stated that the existence of a controlled business relationship (as to service corporations) *may* be a violation of Section 8 because, among other things, a dividend was a "thing of value" and thus, within the prohibition.

In an effort to resolve the issue of the controlled business mechanism and referrals within such a context, Congress once again examined RESPA in the fall of 1981.

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[2]An industry observer noted that the term "controlled business" was coined by ALTA to describe a "settlement service company affiliated with a lender, broker, or real estate attorney."

*Congressional Hearings (September 1981)*

Hearings were held by the Housing and Community Development Subcommittee of the House Banking, Finance and Urban Affairs Committee (97th Congress; 1st Session) at which various government, industry and public witnesses presented their views.

The testimony soon revealed a wide range of positions and attitudes toward RESPA itself — well beyond the issue of controlled business, or in some measure, because of it. Once again there were pleas to repeal the statute altogether or, to reallocate disclosure requirements; there were proposals that the settlement transaction be bundled together by the lender and offered to the consumer as a "one stop" service.

The Subcommittee Chairman, Henry B. Gonzales (D-Tex.), opened the hearings by framing the issue:

> As we all know, whenever a person buys a home there are a number of essential steps involved for closing or settling the transaction. Among these essential steps is the procurement of title insurance. Real estate professionals include brokers, mortgage lenders, attorneys, and builders. These professionals are in a unique position to influence the buyer's choice of title insurance and other elements essential to real estate settlement. The typical home buyer is not an attorney, broker, or otherwise acquainted with the varied and complex details of real estate settlement. Like the physician's patient, the buyer depends very heavily on the recommendations of the professional. Buyers might not be aware that title insurance companies can be controlled by the parties that recommend that title insurance be bought from a certain offeror. Buyers might not even be aware that they have a choice in the matter.
>
> Whenever the buyer is faced with a situation in which a real estate professional steers him into a title insurance in which that professional has an interest, *that buyer is faced with a controlled business problem.* The buyer probably will be unaware of the fact that he is being steered into a controlled business. He has no way of gauging the soundness of their business and probably will not be aware that he might do better by shopping around. Therein is the problem (emphasis added).

*Governmental Witnesses (September 15)*

The Subcommittee first turned to HUD for its recommendations. The witness, Dr. E.S. Savas (Assistant Secretary for Policy Development and Research), while acknowledging the 1980 HUD opinion that such arrangements *may* violate RESPA, went on and voiced *both* sides of the argument:

> We have found, however, that a controlled business arrangement may be the cheapest and most efficient provider of that service, and referral to a controlled business saves the consumer time and money in searching. Indeed, we would argue that referral fees may lower the total package price to the consumer. It is equally true that the controlled business also can be inefficient and costly, but can remain in business because of referrals from its parent company. In a settlement market, however, we have discovered that consumer shopping and awareness are minimal; therefore, no natural market forces will ever correct this inefficiency.

After a brief recitation of the process that occurs when a consumer prepares to buy a home, Savas stated that RESPA should be replaced with a mechanism called "lender packaging," a concept which, he urged, "eliminates the concern about controlled business and kickbacks or referral fees." The lending institution would be required to offer a package of all the applicable settlement services, including title insurance, as a part of the loan transaction for one quoted price. HUD's position on controlled business was then put forth. The witness reconfirmed his department's recommendation contained in its recently submitted report to Congress (September 10) on RESPA. If Section 8 is not repealed entirely, in favor of lender packaging, it should be amended to prohibit *any referral* by one settlement service provider to a wholly or partially owned subsidiary providing *another* settlement service. The HUD report itself stated that "we believe that a prohibition against kickbacks and unearned referral fees must logically and legally include a prohibition against *controlled business arrangements*" (emphasis added).

In contrast to the HUD position, the witness for the Federal Home Loan Bank Board, Thomas P. Vartanian (General Counsel), alluded to his industry's service corporations in connection with RESPA.

He admitted that "due in part to RESPA's ban on compensated referrals, service providers such as real estate brokers and lenders have acquired an ownership interest in other settlement providers and automatically make referrals to the controlled entities." However, in an attempt to protect the interests of lenders who establish such ancillary providers (service corporations), Mr. Vartanian argued that there was no justification in the legislative history of RESPA to indicate that Congress intended that payments *other than those directly related to the referral itself* should be prohibited. (Although his remarks were directed to a lender's involvement in ancillary services, the argument could apply to other types of CBA participants as well.) He continued:

> Additionally, had RESPA been intended to include *dividends* as a fee, kickback, or thing of value, it would almost certainly have addressed a number of issues raised by HUD's [interpretive rule]. For example, dividends from a corporation are not contingent upon the association's referral of business to the service corporation, but on overall profitability of the service corporation as an entity (emphasis added).

The Bank Board witness followed that it was difficult (if not impossible) to trace or identify the varied components of a corporate dividend in an attempt to determine which ones were generated from controlled business referrals. Service corporations, he remarked, often render settlement services to customers referred from sources other than their parent and often engage in non-settlement related efforts, activities all of which influence the corporate bottom line. How could the *controlled business* portion or element of its services be carved out and assigned a value?

RESPA, he stated, simply "was not intended to address payment of dividends to parents by service corporations." The language of the statute (Section 8) was too ambiguous to infer that

a payment of a dividend could somehow be considered the same as the payment of an unearned fee or kickback, both clearly *direct remuneration* arising from a referral of business. "Legislative history and other considerations provide extremely strong evidence that the statutory ambiguity in Section 8 must be resolved to exclude dividend payments from coverage."

Finally, Mr. Vartanian reminded the Subcommittee that to include controlled business referrals in Section 8 would be inconsistent with HUD's own findings in its just-released report to Congress, as well as with the conclusions of an outside consultant to HUD, wherein both, he said, rejected "as unpersuasive ALTA's contentions that controlled business arrangements lead to higher prices and poor quality title insurance work." The HUD report, he stated, found that "elimination of controlled business would not necessarily benefit consumers and [quoting the report] 'there is reason to believe such relationships are, in fact, economically efficient.'"

The witness from the Federal Trade Commission, Thomas H. Stanton, (Acting Director, Office for Policy Planning), focused directly on the economic benefits derived from the conduct of real estate settlement services through controlled businesses and urged that such arrangements be encouraged. He stated that settlement costs should go down and praised the concept of combining related settlement services, cautioning that "artificial restrictions on the sensible bundling of goods and services should be looked at with a jaundiced eye." He concluded his testimony to the Subcommittee by commenting on the most extreme of the legislative proposals before it:

> A prohibition [of the CBA] is the most restrictive of all the remedies considered here, and there are therefore solid grounds for requiring stronger evidence that the practice is on balance harmful before that remedy is imposed. At a minimum, a flat prohibition should not be adopted without first considering the other, less restrictive options.

And, judging from some of the questions submitted to the witnesses by members of the Subcommittee, options to outright prohibition were being considered. Most of the suggested alternatives focused on consumer education and disclosure.

Nevertheless, panel members continued to probe the allegations of unfairness. From Chairman Gonzalez:

> Mr. Stanton, . . . your recommendations seem to be in contradiction with the antitrust policy of the Attorney General of the United States. I quote from "The Pricing and Marketing of Insurance -- a Report of the Department of Justice to the Task Group on Anti-Trust Immunities" . . . The study states:
>
> > To sum up the major evils of controlled title companies where a real estate settlement producer is able to direct the purchaser of a title insurance policy to a particular title company and at the same time that producer owns the title company, the purchaser is likely to end up, one paying unreasonably *high premiums;* two, accepting unusually *poor service;* or three, accepting *faulty title examinations* and policies from the controlled title company (emphasis added).
>
> How do you reconcile that?
>
> Mr. Stanton. Let me start with the Justice Department study of 1977. I have read it carefully. We simply contend that one must not only look at the price of, say, title insurance but also at the total price of the total package, say, interest rates plus title insurance. One must make a pragmatic examination, is that overall price lower than, say, where an independent lender and an independent title company offer the same services?
>
> It is simply analytically not valid to look only at the price of title insurance in both cases.

In connection with continuing allegations of "high premiums" and "poor service" within a controlled business context, two of the government witnesses responded. From Mr. Vartanian:

> Overall, the [HUD commissioned] study still concluded that there was insufficient empirical data to establish whether or not controlled business arrangements have an adverse effect on settlement prices.

> Additionally, HUD's report to Congress on RESPA explicitly labeled this argument unpersuasive and found that generally, the prices of title insurance have remained constant at the same uniform percentage level, regardless of whether the insurance was sold through an independent or "controlled" title company. HUD also found that there was reason to believe that controlled business relationships are economically efficient and could lead to reduced costs for consumers if freely allowed.

d, from HUD's Savas:

> I submit that the anecdotal evidence submitted by the title insurance industry to the Committee does not prove that controlled business arrangements necessarily raise consumer costs.

While the Subcommittee members and the witnesses from the government agencies may e considered the various options available in an attempt to resolve the controlled business ıe within a RESPA context, witnesses representing independent title insurers wasted no time ɔating alternatives — they wanted an *absolute prohibition* of controlled business arrangements.

*le Industry Witnesses (September 15)*

Witnesses from the title insurance industry spoke of the ills brought about by controlled iness activities in their areas of the country. This time the focus turned directly to the real ıte broker.

One independent insurer (Clyda Guggenberger) complained that "[w]e lost our customers ernight, not because [the competitor] offered better services, but because real estate brokers an outrageous violation of the agency principle were steering their customers to their own row companies and title entities."

She remarked that many real estate agents in her area would have preferred to continue ıding customers to her company but their supervising broker, who owned a "tie-in-entity,"

lirected "his salespeople to take every transaction to his company [or rather] forces, mands, harasses threatens, and even 'fines' are more accurate descriptions of the kind exerted by the brokers" — all, she added, at higher prices for the service.

witness representing ALTA, James L. Boren, joined in the criticism of the controlled ·angement. He spoke of the need for the consumer to obtain the *disinterested* advice te professionals in a transaction. Such is not possible if the professionals have a terest in the selection of title insurance services; they "invariably steer their clients ers to that provider, irrespective of the competitive merits of the services and rates other title insurance providers." Mr. Boren went on to list the "major anticonsumer npetitive consequences" caused by the *controlled* title insurance agency: (1)"no : pressures to maintain the quality of its services or the reasonableness of its charges," ious competitive disadvantage placed on the independent company or agency," (3) the asing financial benefits" offered to the professionals who have financial interests in ınd (4) the serious conflicts between the interests of the owners of a "controlled" title he interests of the consumer and title insurance underwriter.

ALTA witness agreed with others that most consumers do not shop for title insurance not have the time, knowledge, or incentive to shop the market in order to select the title insurance services which offers the best combination of price, service and policy . . it is inevitable that the great majority of consumers will continue to look to the lations of their broker, lender, or attorney in selecting a source of title protection."

Boren urged that the direct kickback or referral fee recognized and prohibited by in 1974 was not the only form of financial benefit unfairly influencing the

ommendations of a referring party. Other "arrangements," he said, have proliferated since the 1-1970s, whereby professionals who steer their customers or clients to controlled title insurance npanies have been unfairly enriched. Moreover, whether such benefit from the arrangement n the form of a dividend or capital appreciation of stock, often the financial gain even *exceeds* : amount which, in an earlier time, came from the direct kickback or referral fee.

As did many witnesses, he cited the 1977 Department of Justice report (noted by airman Gonzalez above) alleging the three "major evils" of *high premiums, poor service,* and *lty title examinations* arising from the operations of the CBA.

In the report, the culmination of an 18-month study of the insurance industry, the artment had offered its views in an effort to "stimulate comment by all interested parties and courage] consideration of the issues by regulatory and legislative bodies at both the state and eral levels." The study cited the controlled business issue and noted a problem area left ittended by the 1974 RESPA legislation:

> While [RESPA] is designed to close the front door to rebates and kickbacks in the title insurance business, a loophole has appeared which may ultimately cause a problem worse than outright kickbacks. This loophole is the title company affiliate of a real estate agency, which we will refer to herein as the "producer's affiliate" or "controlled title company."
>
> * * *
>
> Title companies controlled by producers have been steadily increasing in number since the passage of RESPA. They possess several anticompetitive features. One is that they encourage, on a new level, the type of activity sought to be eliminated by RESPA.
>
> * * *
>
> This controlled placing of settlement services has a definite tendency to increase the price paid by the consumer.

After citing the report, the ALTA conclusions and recommendations were put forth to the subcommittee:

> Under our private enterprise system, consumers are best served when competitors are required to compete on the merits of their prices and services, and when all competitors have a fair and equal opportunity to compete. Because of the strategic role played by the real estate professional is assisting the consumer in selecting a provider of title insurance services, it is essential for all providers to have a fair and equal opportunity to compete on the merits for the favorable recommendation of these real estate professionals. This opportunity is effectively foreclosed when the real estate professional is permitted to benefit personally from his recommendation to the consumer. If such financial interests are permitted, fair and effective competition on the merits will be lost. And the ultimate loser will be the consumer.
>
> Accordingly, on behalf of the American Land Title Association, I urge this subcommittee to introduce and to act favorably upon legislation that would clearly and comprehensively prevent real estate professional who are in the position to influence the consumer's selection of a provider from benefitting financially from that selection.

By the time the industry witnesses ended their presentations, a consensus had generally been delivered to the Subcommittee that the controlled business entity was such a threat to the consumer (and to them) that nothing less than a federal legislative ban was necessary.

However, when pressed for evidence of *high rates, poor service* and *faulty title examinations*, the witnesses at best provided anecdotal references to consumer disservice. Often in response to a question seeking such clear-cut evidence, a witness would reply not with an example, but with an expansive warning. For example, one witness (Boren) stated:

> ALTA believes that focusing on whether any particular controlled title insurance agency is currently charging more -- or even less -- than other title insurance agencies may cause members of the Subcommittee to fail to focus on the primary, long-term issues that should be of concern to the Congress: whether the interests of consumers will be served if markets are allowed to develop in

> which real estate brokers or mortgage lenders refer the customer's business to captive title insurance agencies and where independent title insurance companies are effectively foreclosed from competing for the recommendations of those real estate professionals, or whether, in contrast, the interests of the consumers will be served if markets are allowed to develop in which the real estate professional has no conflicting financial self-interest in making recommendations to the consumer regarding the title insurance provider that offers the best combination of price and service.

Most of the concerns of the independent title insurance agents and the title companies who testified against the controlled businesses concept were similar to those highlighted by the ALTA witness.

One independent agent (Gerald Peck) spoke of the inherent conflict of interest present within the controlled business device, a mechanism that presented (or threatened) the exercise of sound and independent judgment. A controlled title insurance agent

> which may be nothing more than a small shop, a one- or two-man operation, can be pressured to close and ignore title problems because of the economic pressure brought to bear by the person controlling that company who is a party in the transaction. His boss, for all intents and purposes, is the broker who is anxious *to get his deal closed and will oftentimes press inordinately to have title questions passed over* (emphasis added).
>
> * * *
>
> Agencies controlled by savings and loans or a real estate broker, for example, are inherently subject to *pressure to short cut their search and examination operations or to ignore title problems* that if disclosed might jeopardize or slow down the consummation of the transaction (emphasis added).

Another land title witness (Richard Bossard) did, in fact, cite examples of faulty title work brought on by the pressure to overlook possible defects in titles within a controlled business

atmosphere.

*Real Estate Witnesses* (September 16)

Witnesses representing the real estate industry followed with their views, some voiced in general terms, stressing the economic and market benefits of the CBA on the whole, others in more specific terms in the manner of a rebuttal of earlier comments of the critics. And, their remarks were directed more to the witnesses from the insurance industry rather than to the government spokespersons.

A witness from the National Association of Realtors (Donald H. Treadwell) noted that the overall concern from the point of view of his industry was the ease and economy of transfer of interests in real property. He urged that the question should be whether or not the actions of those involved in controlled businesses resulted in "either diminished service or increased costs to the consumer." In a criticism of the independent insurer he charged that many broker-title insurance relationships exist and are developing solely for the purposes of "efficiency rather than profit," remarking that it is the company that provides the best and fastest service that will survive.

A witness from the savings and loan industry (Barry Tate) reminded the Subcommittee that existing antitrust laws and bank rules prohibit forced steering or "tie-ins," i.e., conditioning the sale of one product on the sale of a second product. He suggested that the whole issue of controlled business should be considered in the context of the nation's general antitrust laws — laws which "contain long standing and well understood restrictions regarding monopolization, conspiracy to monopolize, attempts to monopolize, and so on."

The witness cited numerous examples in companion industries wherein parent entities make referrals to subsidiaries or affiliated bodies and no allegation of illegal or inappropriate conduct is raised; auto dealers, appliance retailers, and hospitals all use a form of referral to their own repair, service, or professional branches without argument from independent or unaffiliated service providers. "Settlement services are not distinguishable from any of these examples."

One particular company invited to testify as part of the group from the so-called "real estate professional sector" had been singled out by the critics of controlled business because it, according to them, exemplified the combining of settlement services through wholly owned service companies. When the time came to present its testimony, the remarks of the witness were as much directed to the specific charges as they were addressed to the controlled business issue in general.

The witness, Stanley M. Gordon, was testifying on behalf of a broker (Coldwell Banker & Co.) which provides various ancillary settlement services within its corporate structure. He responded to the ALTA charges. First, as to steering, he noted that his company's title agents were independent contractors and were not required to send their business to the parent — and often did not. Moreover, its own real estate brokers were similarly under no such requirement. He stated that "they [the brokers] are unimpressed by the fact that we have a title agency and we only obtain business from them after demonstrating good service."

To allegations that broker-owned title agencies charge higher fees, Mr. Gordon cited both a State of California-sponsored report refuting such claims and the HUD study (noted above) which contained similar findings. As to charges of inferior title service he reminded his audience that under state law his company has an indemnification responsibility to the title insurer, thus

discouraging efforts to ignore or gloss over title defects.

Another witness, also testifying on behalf of Coldwell Banker (Charles R. Hilton), challenged his critics by asking for the underlying data justifying the oft-repeated allegations:

> We have been fighting against nonfacts for five years, regarding title hearings, kangaroo court-type hearings. We fought nonfacts and found findings of facts where there were no facts. I haven't heard any facts at this hearing that would lead anybody to the conclusions that real estate brokers who have a controlled ancillary service charge higher fees -- maybe I missed it -- or that they offer poor service, or that they write defective policies. That is the most ludicrous thing that I think anyone could ever say: that a real estate broker, for a small or large commission, would write around a defect in the title, which would cost them many times over the amount of their commission.

Finally,

> I suggest to you that ALTA is asking for protectionist legislation based upon a potential evil. And they can't say it's anything but potential. But the potential exists, with or without controlled business.
>
> * * *
>
> Now, the surveys that I have observed in -- questions to clients indicate that the real estate broker, who is the direct point of contact in normal situations with the buyer and seller -- they expect the real estate broker to walk this transaction through to conclusion, which means that the real estate broker is put in a position of some responsibility in connection with each of the services offered -- be it survey, or title, or loan; whatever -- and to help that buyer and seller through the maze that they are confronted with.
>
> I suggest to you, Mr. Chairman, that if the real estate broker has responsibility for those services, they should be entitled to then be involved where they can offer the finest service available.

*Public Witnesses (September 16)*

The remaining grouping of witnesses testifying before the Subcommittee were categorized as "public witnesses" and came with diverse views on the controlled business issue.

A former HUD official (Thomas C. Collier) stated that "controlled business arrangements provide a sophisticated camouflage for the payment of kick-backs simply for the referral of settlement service business." He defended the value of anecdotal evidence in the absence of *clear proof* to show that controlled business arrangements did cause prices to increase, and he called for their prohibition entirely.

Another former HUD official (Robert R. Elliot) took a different approach and noted that outright prohibition of the CBA would contradict established antitrust policy which treats a parent and its subsidiary as one entity — a composite of *one* which can't give *itself* a kickback. He went on to demonstrate the awkward situation that would exist if HUD allowed a corporation, through its subdivision, to render more than one settlement service to customers because it has "control" over the subdivision (to whom it "referred" business), but would not so allow an entity to make referrals to a provider in which it had an equity interest which interest fell short of the requisite "control." He concluded by urging that the anti-tying policies and regulations already in place should be sufficient warning to prevent consumer abuse. Notwithstanding such consumer protections, he charged that

> the proponents of a so-called "controlled business" prohibition wish to go a step further and stamp out all competition from such subsidiaries where they refrain from such tying. I cannot agree that such an anti-competitive step is desirable, when alternatives are available which will increase competition.

***egislation Introduced.***

There was no more formal legislative activity on the controlled business issue in the !ouse until a housing bill was introduced (H.R. 6296) seven months later (May 6, 1982) in the :cond session of the 97th Congress. The bill, part of a lengthy measure entitled the "Housing nd Urban-Rural Recovery Act of 1982", contained an amendment to RESPA which dealt with ıe controlled business arrangement.

The proposal first defined a "controlled business arrangement" by setting forth its two rerequisite components — the qualifications of a "person" (or "associate") in a position to refer usiness to a settlement service provider and the *fact* of a referral to that provider. Once such vo conditions were satisfied a controlled business arrangement exists.

Given then the presence of the arrangement, the bill allowed that a person in such a ontext could make a referral without violating Section 8 of RESPA if three conditions were met. hus, while the controlled business critics in 1981 favored the ALTA "solution" and wanted the loop-hole" in the 1974 statute closed with a complete ban on such arrangements, the legislation hich was finally presented rejected such an extreme measure and conditionally permitted them, lbeit with percentage limitations.

The proposed amendment approved of referrals within controlled business arrangements o long as:

> (1) the nature of the ownership *interest is disclosed* at the time of the referral;
>
> (2) *no unreasonable restrictions* are imposed on the buyer's or seller's selection of the settlement services provider for which the buyer or seller bears the cost; and
>
> (3) the only *thing of value* that is received from the arrangement is the return on such ownership interest (emphasis added).

ese three operational conditions of a controlled business referral transaction were further ject to an administrative condition placing a percentage limit on such transactions:

> A title company, private mortgage insurance company, or escrow services company may participate in any transaction involving a controlled business arrangement for that company if such arrangements are permitted [as noted above] and if in *any calendar year the total number of such transactions does not exceed twenty percent of all transactions in which that company has participated*; . . . (emphasis added).

e 20% limitation did not apply in certain circumstances — in a county with a population of less n 25,000 or in an instance where there is negligible ownership in a service provider by its ferrer."

As thus proposed, the amendment created two tests, one containing the three mandatory ments of the referral and transaction itself, and the other, a numerical limitation on such nsactions. The latter test was being applied to ensure that entities participating in controlled siness arrangements could survive and flourish in the industry without reliance on their iaranteed" sources of business. Therefore, according to the Banking Committee, in any endar year, title companies and other recipients of business from "real estate professionals" h whom they have an affiliation "would have to obtain a predominant percentage of [their] siness (80 %) from sources other than referrals by those persons."

The 1981 hearings had devoted little, if any, attention to such an unexpected treatment the controlled business issue. The witnesses variously had urged either a complete prohibition the arrangement or a pragmatic acceptance and encouragement of it, not a hybrid. However, Committee stated its belief that,

> in light of the unique nature of the services provided by these types of entities, permitting these companies [title, mortgage insurance or escrow services] to obtain

> all or a significant portion of their business from referrals by real estate brokers, mortgage lenders, builders, or attorneys that may have ownership relationships with them will enable these companies to be insulated to a great degree from having to compete on the merits of their prices and services for their business. In addition, significant conflict of interest problems may arise when these companies are owned or controlled by parties who have a direct interest in the real estate transaction.

he Housing and Urban-Rural Recovery Act of 1982, the major housing bill in which the RESPA mendment was a minor inclusion, did not pass in the 97th Congress. However, much of its ubstance was carried over into the 98th.

*8th Congress: RESPA*

On January 3, 1983 a successor bill was introduced in the House (H.R.1) which was ubstantially similar to the 1982 measure, including the RESPA controlled business amendment. nd again the proposed language to be included in Section 8 of RESPA would allow referrals be made within a controlled business arrangement if the three conditions of:

1) disclosure

2) no required use ("anti-tying"), and

3) thing of value

re met and, additionally, if such referred business is limited to 20% of the total transactions of ne service provider for any calendar year. The percentage restrictions caused a great deal of oncern for companies in the industry which had either fully integrated as multi-service orporations or which had affiliated themselves with other settlement service providers. To some bservers the limitations constituted the functional equivalent of a ban on controlled business rrangements; the proposed legislative language became known as the "shut town" provision.

*House Markup*

In April 1983, at the Housing Subcommittee markup on H.R.1, the issue of the percentage limitations was raised and debated. An amendment was offered by Representative Barney Frank (D-Mass.) whereby he proposed that the restrictions be removed from the Subcommittee print, and that another disclosure requirement (written estimate of charges) be added to the list of conditions. He remarked:

> Mr. Chairman, I think we should be protective of consumer interests.
>
> I have listened and read and talked to people, and it does not seem to me that there is damage being done to consumers by allowing this newer form of business. I say newer because it's a form of business, the controlled business, that has grown up relatively recently.
>
> My amendment does say that anyone who has a controlled business would be required to disclose the fact that he or she or his entity owned the business to which referral was being made; *that a written estimate of the range of charges would have to be offered*; and that there could be no requirement of a tie-in; and also that the only charge for the service for the controlled business would be the normal and customary charge of the controlled business. There would be no referral fee...(emphasis added).
>
> I do not see that a major interest is served or even that a minor interest is served by preventing these controlled businesses. They have grown up in the normal course of business. I think they respond to the market. There are obviously different forms. There are title insurance companies that are independent; there are title insurance companies that are owned by real estate brokers. To them I say may the best company win.
>
> ....I don't see that any consumer interest is harmed, and I think that we otherwise interfere with some established business relationships. To require that someone at the end of the year have only had 20 percent of his business from one place is a little bit like telling you to get off the subway stop before I do. It's kind of hard to figure that out and make the decision before you have all the information.

Mr. Frank's amendment to the Subcommittee print also did not preclude a state from enacting more stringent restrictions on controlled business arrangements. He noted that his measure "does

not propose to preempt state law. If a state sought to impose tighter restrictions with regard to controlled businesses nothing in this would preempt the state from exercising further regulatory power if it thought that that was necessary."

At the markup, as a counter to the Frank proposal, Representative Jerry M. Patterson (D-Cal.) offered his amendment which retained restrictions, but to a lesser degree. He proposed to place the percentage limitations solely on arrangements involving title companies (rather than controlled arrangements of other service providers) and then at a more lenient level of 50%, i.e., a title company participating in a transaction involving a controlled business arrangement for that company would have to obtain only 50% (rather than 80%) of its business from referrals outside that context. Mr. Patterson also stated that his proposal would provide for injunctive relief as a remedy in place of the harsher penalty of treble damages to be paid by the violator. He sought support for his amendment:

> The 50 percent public business requirement will ensure that all of the customers will be purchasing title insurance from an entity that has demonstrated it can compete successfully in the marketplace.
>
> * * *
>
> If you eliminate the 50 percent or the 80 percent which is in the bill you will in essence open it up for every lender or every realtor that wishes to dictate in a sense, and while I think the disclosure goes in the right direction, I'm not at all sure that it would accomplish totally what we want, and that is to have the consumer able to purchase title insurance wherever they want to as opposed from a recommended source.

Mr. Frank responded:

> Again, there has been no showing anywhere that there is a consumer penalty if a title company is owned by a real estate company rather than if it is not, and that seems to me ought to be the touchstone which is necessary for us to get into the field.

So the difference between the gentleman's amendment [Patterson's] and mine is that he would continue the restriction on controlled companies, he would lessen it a little bit. I still think it becomes very awkward. Being subject to a 50-50 requirement as to where your business comes from at the end of the year can be kind of a difficult situation if you are not sure where your business is going to come from.

I think the gentleman has explained his amendment clearly and I think the difference continues to be that I do not believe that the evidence shows that consumers are penalized. If the consumer has to be told what the price will be, told that there is a tied relationship, a controlled relationship, [and that he] cannot be required to use their service, then the consumer is free to shop.

I think there is a certain artificiality, as all of us would agree, in the notion of people shopping for title insurance. The poor consumer buying a house is lucky if he remembers to buy a rug the week after, he is so busy with all this stuff.

But for those who are able to go out and shop this preserves their freedom and preserves the right of the states to go beyond that.

Representative Bill Lowery (R-Cal.) added his remarks in support of the Frank amendment:

The premise on which both ... the subcommittee print and the amendment by [Patterson] is based is that controlled business, . . . leads to higher prices and inferior service and is thus anticompetitive. Yet from the date of the hearings in September of 1981 until now, a period of a year and a half, no evidence has been produced by the proponents of this provision that shows that these problems do in fact exist.

The Subcommittee took a vote and defeated the Patterson substitute amendment which was designed to retain a degree of percentage limitations. It then passed the Frank amendment eliminating the restrictions altogether.

In May 1983 the House Committee on Banking, Finance, and Urban Affairs passed the bill as amended by the Subcommittee and submitted its report on H.R.1 to the House.

In its report, the Committee, in resisting the effort to prohibit controlled business arrangements (or even to limit them), stated that it was amending RESPA



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> to clarify that controlled business arrangements in federally related mortgage transactions are a permissible method of doing business so long as a good faith effort is made to disclose the existence of the controlled business relationship at or prior to the time of referral, a written estimate of the range of charges generally made by the provider is given, and no person is required to use a particular service provider (with exceptions to protect the lender's interest and to allow attorneys to act as title agents in certain circumstances), and the only payment received from the arrangement is a return on the ownership interest or franchise relationship.

After a description of what constitutes a "controlled business arrangement" the Committee stated that such types of business activities should be allowed in the industry:

> The issue of controlled business has been explicitly considered and the Committee has adopted language which establishes that controlled business arrangements do not violate RESPA so long as certain conditions are met. In doing so, the Committee evaluated the evidence presented on both sides of the issue and determined that controlled business referrals should not be prohibited.

The conditions to their acceptance were then set forth (disclosures, "anti-tying" and "thing of value"). The obvious omission of the condition sought by the title insurance industry — the percentage limitations, was explained by the Committee:

> Although consideration was given to imposing a percentage limitation on the amount of controlled business that could be transacted by a controlled title company, the Committee concluded that at the present time such limitations should not be imposed at the federal level and that the disclosure and anti-coercion provisions of [the bill] might prove sufficient to remedy the problems in this area.

However, the report alluded to the provision in the legislation which was to become the signal for subsequent state activity:

> The [amendment] also permits the states to impose more stringent limitations on controlled business arrangements should they so choose. . . . Certain states have already adopted laws that impose stricter limitations.
>
> The provision reflects the Committee's view that, while the disclosure and anti-coercion provisions contained in the bill may be the proper approach for the Federal Government to take . . . in the context of Section 8 of RESPA, individual states may conclude that more stringent limitations, particularly in connection with

the problem of controlled business in the area of title insurance, are needed. Thus, the controlled business amendments to Section 8 of RESPA should in no way inhibit the individual states in which controlled business may be a significant problem from adopting those additional measures that they believe will protect consumers and competition.

*House and Senate Passage*

After acceptance by the Senate of the House language, the RESPA amendment was included in H.R.1 which in turn was folded into an even larger piece of legislation which passed on November 30, 1983 and became law on January 1, 1984.

# REAL ESTATE SETTLEMENT PROCEDURES ACT

# COMPLIANCE KIT

**April, 1993**

*Prepared by the NATIONAL ASSOCIATION OF REALTORS®*

# RESPA
# COMPLIANCE KIT

## INTRODUCTION

The Real Estate Settlement Procedures Act (RESPA) was enacted in 1974 to provide consumers with disclosure about closing costs and to prohibit unearned fees (kickbacks/referral fees). It was amended in 1983, (The Housing and Urban Recovery Act of 1983), to include Controlled Business Arrangements (CBAs) - diversified real estate companies that offer more than one settlement service.

The final rule revising the regulations for RESPA, effective December 2, 1992, conforms to section 461 of the Housing and Urban-Rural Recovery Act of 1983 (HURRA). With this rule, the Department of Housing and Urban Development (HUD) addresses the application of RESPA to Controlled Business Arrangements (CBAs), Computerized Loan Origination (CLO), and clarifies certain matters which were previously only covered by informal legal or program advice.

Following is an overview of those sections affecting the majority of real estate licensees with a particular emphasis on Sections 3500.14 and 3500.15. Boards of REALTORS® are authorized to duplicate this kit or portions thereof for distribution to members, and for inclusion in Board newsletters. Relevant definitions and a list of resources are included at the end of this kit.

## SECTION 3500.14 - Prohibition against kickbacks and unearned fees.

Commonly referred to as Section 8, this is the heart of RESPA and consumer disclosure is the soul. Section 8 pertains to referral fees, kickbacks and unearned fees. The key language, unchanged since 1974, is: "No person shall give and no person shall accept any fee, kickback, or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a settlement service involving a federally-related mortgage loan shall be referred to any person..." (Federal Register, Volume 57, No. 212, on November 2, 1992)

Much of the RESPA controversy during the last four years was generated by allegations of illegal referral fee arrangements between lenders and real estate brokers. Examples submitted to HUD were advertisements/flyers from mortgage brokers offering to pay real estate brokers/agents for the referral of business and reports of demands from real estate brokers to lenders for referral fees for placing mortgage business.

These practices have been prohibited by Section 8 of RESPA since 1974, however it became clear in the investigatory process that few in the industry understood that to be the case. In response to the real estate industry's demand for more rigorous enforcement, HUD Secretary, Jack Kemp, established a special unit to investigate reports of violations of the kickback provisions in Section 8. As of April, 1993, there are hundreds of complaints filed with HUD.

In summary, paying or receiving a fee or thing of value for the referral of business related to settlement without rendering a service is a violation of RESPA. Examples of how HUD is interpreting this provision include the following: (1) referrers have been supplied with computer equipment and fax machines that can be used to communicate with the providers, but also may

be used by the referrers for their own purposes. HUD has taken the position that providing "non-dedicated" equipment violates Section 8; (2) real estate brokers accepting a portion of a title agent's premium or excessive fees from mortgagees for taking a credit application have been required to end these practices; (3) real estate brokers who rent space to other settlement service providers must be sure that the amount of the rent is not adjusted based on the number of referrals between the two entities (no rental rebates allowed).

While the "anti-kickback" provisions have been in place since 1974, the debate in recent years was over CLO payments to real estate licensees. Critics of arrangements between real estate brokers and lenders to provide consumers with mortgage services contend that payments for CLO services are indirect referral fees and, therefore, a RESPA violation. The CLO provision of the final regulation was debated at great length publicly and privately over the last four years and was the subject of Congressional hearings in both the House and Senate in 1990. The final rule recognizes the legitimacy of CLO payments and allows mortgage information/origination systems provided the borrower pays the fee and the provider of the service provides the disclosure set forth in the rule (attachment A).

Section 8 of RESPA permits: (1) payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers; (2) payment to any person of a bona fide salary or compensation or other payment of goods or facilities actually furnished or for services actually performed; (3) an employer's payment to its own employees for any referral activities (new) and (4) any payment by a borrower for CLO services, so long as the disclosure set forth by HUD is provided the borrower (new).

The employer/employee exception from Section 8, listed as (3) above, is intended to be narrow. For example, a manager of a local office of a large real estate company may receive cash bonuses or other compensation if home buyers obtain their financing through an affiliated mortgage banker, or have their title and settlement work done at an affiliated company. If real estate agents are viewed as "employees" of a broker and the CBA provisions in the rule are satisfied, a real estate broker could pay its sales associates a fee for referring applicants to a mortgage or title company affiliate. The final rule makes it clear that the recipient of the referral–the affiliated provider of services–may not pay a fee or thing of value to the source of the referral.

The final rule indicates that providers of multiple services must perform distinct services in return for each payment they receive. As an example, the regulation indicates that an attorney representing a party in a real estate transaction may not also receive a fee as a title agent unless the attorney independently performs "core title agent services" and has liability for these services. These services include: evaluating the title search to determine insurability of title; clearing underwriting objections; issuing policies and, where customary, issuing title insurance commitments, performing title searches, and conducting closings.

## Section 3500.15 - Controlled Business Arrangements (CBAs)

A controlled business arrangement is a diversified company created to package real estate related services. A long standing issue under RESPA is whether a Section 8 violation exists when referrals are made between affiliated entities, but the provider of the settlement service does not make a direct payment to the referral source. Section 461 (b)(3) of the Housing and

Urban-Rural Recovery Act of 1983 ("HURRA") amended RESPA to clarify that the prohibition on kickbacks and unearned fees should not be construed as prohibiting these arrangements as long as certain requirements were fulfilled.

Under the final regulation a CBA is permitted if the following conditions are satisfied:

• the referring party provides a Controlled Business Arrangement Disclosure Statement (see Attachment B) on a separate piece of paper no later than the time of referral;

• the nature of the relationship (ownership and financial interest) between the referring party and the provider of the settlement service is disclosed; and

• an estimated charge or range of charges generally made by the provider of settlement services is provided.

The final rule allows consumer discounts for the use of affiliated service providers. Investigations to date have focused primarily on real estate brokers who own an interest in a mortgage banking company or title agency. In these instances, HUD has been particularly tough when consumers have not been informed of the affiliated relationship or of the true costs charged by the affiliated entity. (Phillip L. Schulman, Esquire, "RESPA Enforcement – A Report from the Front")

HUD is also concerned that CBAs not be simply "sham companies"– a group of settlement service providers joining together to form companies that do little or no work yet receive excessive fees. Earlier versions of the rule indicate that HUD believes the very existence of a CBA implies a potential RESPA violation.

<u>State laws governing CBAs will be viewed as inconsistent with, and hence preempted by, RESPA if they do not give more protection to consumers and/or competition.</u>

## CONSEQUENCES OF NON-COMPLIANCE

Any person or persons who violate Section 8 of RESPA (12 U.S.C. 2607) 3500.14 or 3500.15 shall be fined not more than $10,000 or imprisoned for not more than one year, or both, for each violation.

### Section 3500.17 - Escrow

Section 10 of RESPA relates to the escrow account maintenance provisions which were enacted to prevent lenders from requiring that excessive amounts be maintained in escrow accounts for the payment of taxes and insurance.

Although confusion has arisen regarding acceptable accounting methods for purposes of Section 10, the December 2, 1992 final rule did not address Section 10. Therefore, on January 21, 1993, HUD issued RESPA Interpretive Rule 1993-1 which states as follows:

"Both individual (or) single item analysis" and "aggregate (or) composite analysis" are acceptable escrow accounting methods under sections 10 (a) (1) and (2) of RESPA for determining the

maximum amounts which may be accumulated in escrow accounts for purposes of this Section (Federal Register, Vol.58, Number 12, January 21, 1993).

## COMPLIANCE CHECKLIST

DO continue to offer consumers choices when recommending lenders and other providers of settlement services. In the past, when real estate brokers have placed most of their loan business with a single lender, problems have occurred because of the appearance of a RESPA violation. When that lender's competition believed itself to be disadvantaged, the likelihood of an investigation by HUD's Enforcement Unit Increased.

DO provide consumers with full written disclosure as to the fees you are receiving (HUD has provided suggested forms for the CBA and CLO provisions.)

DON'T try to circumvent the rule. It is not worth it to try to hide referral fees. HUD's decision to allow CLOs to develop without unnecessary regulatory restrictions is an opportunity that should not be abused. As a real estate licensee, be sure that the fees you are receiving for CLO services are based on tangible services rendered.

DON'T underestimate the RESPA Enforcement Unit. It has conducted several hundred investigations in its first few years. Most of these investigations were initiated because of complaints from within the real estate industry itself.

DON'T demand referral fees from mortgage brokers/lenders for directing mortgage business. Reports from the field indicate that some real estate brokers/agents believe that RESPA permits this practice. The final rule continues to prohibit referral fees between settlement service providers.

DON'T accept "any thing of value" from mortgage brokers/lenders for loan referrals. You are just as guilty if you receive fees or other Incentives for referring business. Just as in the previous example, reports from the field indicate that mortgage brokers are offering to pay referral fees for business.

DON'T charge excessive fees for CLO and other settlement services. It is clear that HUD intends to try to keep settlement costs down for consumers. Charging too much for a computer link-up or charging duplicative fees for title work is a red flag to the RESPA Enforcement Unit.

## OTHER CHANGES

The RESPA final rule incorporates a number of other changes. Among other items, the revisions:

- Define the making of a mortgage loan as a settlement service (new language);
- Extend coverage of RESPA to refinancings (new language);
- Permit compensation to be paid by lenders to their agents or contractors (mortgage contractors) but require disclosure of such compensation (new language);
- Limit the retention of commissions and fees by title agents to situations where designated "core title agent services" are performed (a clarification);
- Outline HUD's investigatory authority and procedures;
- Provide model disclosures for good faith estimates, CLO fees and CBAs.

### EXAMPLES CLARIFYING THE RULE

Appendix B of the final regulation includes examples indicating that:

- Providing discounted or free services to a person in a position to refer settlement business violates Section 8 of RESPA.
- Receipt of title premiums by an entity that performs no substantial services violates Section 8 of RESPA. Moreover, receipt of title premiums by an attorney representing a client in a transaction is prohibited unless the attorney also performs "core title work".
- Sales of loans closed in the name of a correspondent and funded with the correspondent's own funds or through an advance to the correspondent on a warehouse line are secondary market transactions and therefore exempt from scrutiny under RESPA Section 8.
- Payments by an employer to its employees for referrals to an affiliate do not violate RESPA Section 8, and discounts by affiliates for a package of mortgage, title and escrow services are permissible provided the controlled business arrangements are met.
- Mortgage broker fees, and other compensation such as servicing release premiums or yield spread premiums, must be itemized on the good faith estimate and HUD-1. (Summary source: Phillip Schulman et al., Brownstein, Zeidman and Lore)

**RESPA**
**QUESTIONS AND ANSWERS**

At the request of the NATIONAL ASSOCIATION OF REALTORS®, the law firm of Weiner, Brodsky, Sidman & Kider in Washington, D.C. has prepared the following "Questions" and "Answers" to assist REALTORS® in complying with certain requirements which may be applicable to them under the federal Real Estate Settlement Procedures Act, as amended (RESPA) and the regulations interpreting it (Regulation X) issued by the U.S. Department of Housing and Urban Development (HUD) on November 2, 1992.

RESPA is a difficult federal law. Nevertheless, it is very important for REALTORS® to comply with its provisions. A violation of its anti-kickback provisions can be a serious federal crime. Other adverse consequences also may follow its breach. It is also very important that REALTORS® follow applicable state law requirements.

These RESPA REALTOR® Questions and Answers assume a working knowledge of Regulation X. Not all Regulation X requirements are covered. Accordingly, only a full reading of the regulation itself will provide a comprehensive understanding of the obligations it imposes.

The Answers are as short as possible. They do not include the "whys" or the "buts," either of which could change the Answers in any particular situation. These Answers were prepared in early April, 1993. This area of the law is volatile and controversial. The Answers may change as HUD interpretations or other formal advice about the meaning of RESPA and Regulation published.

The Answers are offered only as general guidance. They are not intended to provide legal advice. REALTORS® are urged to secure particular, current, legal advice applicable to their specific situations before they act or rely upon this general guidance.

<u>Referral Fees/Required Title Companies</u>

**Q:** Can a fee paid to a REALTOR® still violate RESPA, even if it is fully disclosed?

> **A:** Yes. If the fee is not permitted under RESPA (a kickback for the referral of settlement service business, for example, disclosing the payment of the fee will not help either the payor or the payee (although it will help the regulators). Fees not permitted to be paid or received under RESPA are not legalized by disclosure.

**Q:** Can REALTORS® still split fees or commissions with other REALTORS®, without violating RESPA?

> **A:** Yes, if the fees are split pursuant to a cooperative brokerage and referral arrangement or agreement between real estate agents and brokers.

**Q:** Is there any way under RESPA for a REALTOR® or independent real estate agent to be paid a fee by a lender for the referral of mortgage loan business to it?

> **A:** Generally, no. REALTORS® or agents may be paid by a borrower (not by the lender) if the CLO RESPA rules (see below) are followed. REALTORS® or agents may receive a return on their investments in a lender (but not for the referral of loan business) if the CBA RESPA rules (see below) are followed.

**Q:** May a REALTOR® rent space to (and collect rent from) a lender for the lender's use in making loans to the REALTOR®'s customers?

> **A:** Yes. However, the rent must reflect the fair market value of the space, without regard to the value or number of loans made through the use of that space. Affiliated REALTORS® and lenders also may need to follow the CBA rules (see below). FHA mortgagees also need to comply with special rules.

**Q:** May a property seller require a buyer to use a particular title company? Are REALTORS® affected by RESPA restrictions in this area?

> **A:** No to the first question; yes to the second. The better practice is for REALTORS® acting as sub-agents for the seller not to change the title company designated by the buyer, or complete such a designation for a buyer, without the buyer's knowledge or approval.

## Computerized Loan Originations (CLOs)

**Q:** Is there a limit imposed by RESPA on the amount of the CLO fee that may be paid by the borrower?

> **A:** No.

**Q:** May the borrower-paid CLO fee be financed? Be paid only if the loan closes? Be a percentage of the loan amount? Be paid to an independent real estate sales associate?

> **A:** Yes, to all questions.

**Q:** May a lender or mortgage broker pay the CLO fee?

> **A:** No. Only the borrower may pay a CLO fee. If the fee is financed, it is the borrower who is paying the fee from the loan proceeds, not the lender.

**Q:** Does a real estate agent need a license to charge a CLO fee to a borrower?

> **A:** State law may require a mortgage broker or other license, or may prohibit or limit such a charge. RESPA is not a licensing law.

**Q:** Does RESPA require the owner of a real estate brokerage to permit its independent real estate agents to charge CLO fees to borrowers?

> **A:** No.

**Q:** May a lender or mortgage broker that lists its loan products on a CLO system give that system [for example a computer, modem and software] to a real estate broker or sales associate for free or at a discount?

A: No.

Q: May a REALTOR® that purchases or establishes its own CLO system impose upon a lender or mortgage broker that lists loan products on that system a reasonable charge to be listed? May that charge be levied only for loans that close?

A: yes to the first question; no to the second.

Q: Does the CLO fee need to be disclosed on the HUD-1, in addition to the CLO disclosure form?

A: Yes. If the fee is paid in cash by the borrower before closing, disclose the fee as a "CLO Fee", or with words of similar import, that is "paid outside closing" (POC). If the fee is financed or paid in cash at closing, disclose the fee as a charge to the borrower, using the same words.

Q: May a CLO system provider limit the loan products it touts, through the system or otherwise, to those of a single lender or mortgage broker?

A: Yes. State law may provide otherwise, however, and a failure of a CLO system provider to advise borrowers about more competitive loan products may give rise to claims by borrowers against the CLO provider.

## Controlled Business Arrangements (CBAs)

Q: If the required, written CBA disclosure of affiliate relationships is given, may referral fees be paid between affiliated companies?

A: No. Only a return on ownership or franchise investment (or other form of compensation expressly permitted by RESPA) may be paid or received.

Q: May a real estate broker rent space in his office to a mortgage broker? May the mortgage broker close loans for that real estate broker's clients and customers? Does it matter whether the real estate broker and the mortgage are affiliated?

A: Yes, to all three questions. The rental payment must be the fair market value of the space and should not be related to the dollar amount of loans that close. Merely renting space from or entering into a business arrangement with another company (but not having an ownership, franchise or control relationship with that company) will not bring the two companies into a controlled business arrangement.

If, however, the real estate broker and mortgage broker are affiliated through ownership, franchise or control as RESPA defines those terms, the real estate broker would need to provide its customers and clients with a written, CBA disclosure of its relationship with the mortgage broker and would be subject to the "required use" limitations of RESPA. These limitations generally say that a real estate broker cannot require a customer or client to use an affiliated company for mortgage, title or other settlement services.

Q: What percentage of ownership creates a controlled business relationship under RESPA and triggers CBA requirements, such as disclosure?

A: More than 1%.

**Q:** How flexible may the ownership and investment relationships between controlled business entities be, without running afoul of the "return on ownership" limitations?

> **A:** Very. Any bona fide dividend, capital or equity distributions between business affiliates that are related to ownership interest or franchise relationship, and bona fide business loans, advances and equity contributions between affiliates, are permissible. Any such payments that are related to anticipated or actual referrals are not permitted.

**Q:** May the CBA disclosure be combined with any other required disclosures?

> **A:** No. The regulation requires that CBA disclosures be made on a "separate document". Affiliated companies may combine their CBA disclosures, however, in a single, separate document, and additional statements describing the attributes of affiliation may be included in the document, as long as the statements do not interfere with or undermine the required disclosures.

**Q:** Is a partnership the best form for a CBA between a REALTOR® and another settlement service provider, such as a lender, title company, or escrow company? Should the CBA be described in writing?

> **A:** No to the first question; yes to the second. There is no "best" form. Partnerships, limited partnerships, corporations, or limited liability corporations, among other arrangements, may make the most business sense, under various circumstances. No particular business form of the CBA is required by RESPA. However, careful written documentation of the terms of the arrangement is important to help avoid misunderstandings about the nature and basis of the contributions made and profits distributed as a result of the arrangement.

**Q:** Can a REALTOR® require the use by its customer of a lender or other settlement service provider with which it has a CBA? Can such a REALTOR® offer a discount in its commission to encourage the customer also to use such a lender or other settlement service provider?

> **A:** No to the first question; yes to the second. However, a REALTOR® offering such a discount or "package" price for its services must assure that its customer has the option to use the REALTOR®, at the non-discounted price, without also using the lender or other settlement service provider. The REALTOR® also must assure that the package price represents a true discount below the prices for the individual services otherwise generally available and is not made up by higher costs imposed upon the customer elsewhere in the settlement process.

**Q:** May a REALTOR® pay its employees for the referral of settlement service business to others, whether or not the REALTOR® has a CBA with such settlement service providers?

> **A:** Yes, if the Employer-Paid Referral Fee Exemption RESPA rules are followed (see below).

**The Employer-Paid Referral Fee Exemption**

**Q:** Under this Exemption, are independent real estate agents considered to be "employees" of the real estate brokerage companies they represent? May they be paid referral fees by such companies?

**A:** They are not considered to be employees; they may not be paid referral fees under this Exemption.

**Q:** Must an employee work full-time for the employer making the payment?

**A:** No, but there must be a bona fide employment arrangement.

**Q:** Is there any RESPA limit to the amount of the employer payment? Need it be disclosed?

**A:** No, to both questions.

**Q:** Is there any requirement under RESPA that the employee do any work for the borrower, other than make the referral, in order to be paid the referral fee? Need the referral be limited only to businesses affiliated with the employer?

**A:** No, to both questions.

**Q:** Has the Exemption been challenged?

**A:** Two federal lawsuits are pending challenging HUD's authority to include it in the RESPA regulation.

**Q:** If a REALTOR® pays its employee branch managers for the referral of borrowers to the lender with which it has a CBA, may the lender reimburse the REALTOR® for the costs of making such payments? May the lender make the payments, itself?

**A:** No, to both questions.

**RESPA and Conflicting State Law Requirements**

**Q:** Does RESPA replace (or pre-empt) inconsistent state laws applicable to REALTORS®?

**A:** Yes. However, inconsistent state laws or regulations are affected only to the extent of the inconsistency, and, in any event, even if inconsistent, such state laws will continue to be applicable if they are determined by HUD or others to give "greater protection" than RESPA to consumers and/or competition.

**Q:** Will HUD determine whether specific state laws, such as those prohibiting the ownership by REALTORS® of major interests in title companies or other settlement service providers, are pre-empted as inconsistent with RESPA?

**A:** Yes, if requested to do so.

**Enforcement**

**Q:** Are criminal prosecutions likely for kickback violations?

**A:** Yes.

**Q:** Is the RESPA Enforcement Unit active?

**A:** Very. It has arranged for the issuance of scores of investigational subpoenas in the mid-Atlantic area, and in Florida responding mostly to competitor complaints. It has established close working relationships with state law enforcement personnel. It is bringing, and settling, cases.

**Q:** Are private enforcement suits likely?

**A:** Yes. In addition to escrow account litigation, RESPA violations are being combined with other claims, such as anti-trust violations, to secure expanded relief for plaintiffs.

**Q:** What are the "hot" areas of RESPA enforcement activity? What areas are next?

**A:** Today: Responding to competitor complaints, title agent relationships, real estate agent and mortgage broker payments, impermissible CBA returns and failures to give required CBA disclosures. Next: Impermissible employer-paid referral fees and failures to give required CLO disclosures.

## DEFINITIONS

1. For purposes of the final rule, the term **"required use"** applies when a person is "required" to use a particular provider of settlement service, whenever use of such provider is a condition of the availability to such person of some distinct service or property and the person will pay for the settlement service of such provider or will pay a charge attributable in whole or In part to such settlement service. <u>The offering of a package, or combination of settlement services, or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available and must not be made up by higher costs elsewhere in the settlement process.</u>

2. The term **"settlement service"** means any service provided in connection with a prospective or actual settlement, including but not limited to, the following:
(i) The origination, processing or funding of a federally-related mortgage loan;
(ii) The rendering of services by a mortgage broker (including counseling, taking of applications, obtaining verifications and appraisals, and other loan processing and origination services, and communicating with the borrower and the lender);
(iii) The providing of any services related to the origination, processing, or funding of a federally-related mortgage loan;
(iv) The providing of services involving hazard, flood, or other casualty insurance or homeowners warranties;
(v) The providing of services involving mortgage life, disability, or similar insurance designed to pay a mortgage loan upon disability or death of a borrower, if required by the lender as a condition of the loan.

   This is a partial list of settlement services covered by RESPA. Those that have been in place since the 1974/76 legislation are not listed. Some of these are: title services, services provided by an attorney, the rendering of inspections and the rendering of services by a real estate agent or broker.

3. The term **"controlled business arrangement"** is an arrangement in which an individual has more than a 1% ownership interest in more than one settlement service provider and directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider. The statutory definition of a CBA is meant to be broad capturing even informal arrangements the intent of which are to refer business between settlement service providers. While the referral activity itself is not a RESPA violation, payments to shareholders or "affiliated" parties based on referrals generated are a violation. Section 8 prohibitions apply to franchises as well.

4. The term **"secondary market transaction"** is defined as a bona fide transfer of the loan obligation in the secondary market. Mortgage broker transactions commonly called "table funding" is not considered to be a secondary market transaction. As a result, fees paid

to loan origination companies in "table funded" transactions would be subject to RESPA and fees would have to meet the "work performed"criteria of Section 8.

5. The term **"computerized loan origination"** (not formally defined by HUD) is a computerized system for delivering residential mortgage loan offerings of one or more lenders to customers at real estate offices. A "complete" CLO is one that allows a loan counselor in a real estate broker's office to do at least the following: (a) receive complete and timely information on loan prices and other terms; (b) counsel a customer with regard to loan and lender selection and qualify the customer according to lender requirements; (c) take the borrower's application on the computer and transfer it electronically to the lender; (d) automatically print out all the documents that must by law be given to the customer plus all those requiring the customer's signature; and (e) obtain electronic status updates on any loan at any time. (Source: GHR Systems)

6. The term **"federally-related mortgage loan"** now includes refinanced loans and second mortgages.

7. The term **"referral"** includes any written or oral action directed to a person which has the effect of affirmatively influencing the selection of a particular provider of settlement services for which a "thing of value" is paid. "Thing of value" is broadly defined and includes, among other things, services of all types at special or free rates or lease or rental payments based in whole or in part on the amount of business referred.

This op-ed article was prepared to assist you in your efforts to educate other REALTORS® and the public in general about the concept of computerized loan origination systems. You may wish to submit it in its current form for publication in the editorial section of your local newspaper, or you may wish to format it in the form of a letter to the editor. Feel free to submit it under your name, or the name of the local board representative you feel would be the most appropriate.

*"ONE-STOP SHOPPING": THE FUTURE FOR THE REAL ESTATE INDUSTRY*

Being successful in today's real estate marketplace means being diverse. It means giving consumers what they want when they want it. A real estate broker's ability to provide a wide variety of services, including finding a buyer for the seller and matching the buyer with a mortgage to complete the sale, represents the future for the real estate industry. This type of "one-stop shopping" is part of an evolution in home buying, triggered by sophisticated consumers who want the process to be quicker and more streamlined.

One-stop shopping, available through electronic technology, certainly is not new to the services industry. It has long been applied in other industries, such as the travel industry. However, in home sales, this concept is made possible through computerized loan origination (CLO) systems. These systems enable a real estate broker to offer information on financing options and move the mortgage loan application through its initial processing.

CLO systems provide instant affordability analysis, loan comparison and loan tracking services. They directly benefit buyers by providing an option to wrap several steps into one. They indirectly benefit sellers by offering them a mechanism to get their homes sold.

In most circumstances, a real estate broker or sales associate is the home buyer's first point of contact. As a result, buyers have long relied on brokers and associates to compile a listing of mortgage financing that suits their needs. They want help in figuring out monthly payments and determining how much they can afford -- and most of them don't want to wait until they visit a mortgage broker to get this information.

It should be pointed out that point-of-sale financing is not just buying advice that real estate brokers suddenly decided not to give free anymore. Providing the most up-to-date mortgage information available to home buyers -- information they expect -- requires the installation of computerized networks. This installation costs money. As a result, it is perfectly reasonable for real estate brokers to collect a fee to cover the costs for providing these services. It is essentially the same type of fee that a consumer would pay a mortgage broker. The only difference is that the middleman -- the mortgage broker -- is eliminated.

The National Association of REALTORS® (NAR) firmly opposes the payment of fees based solely on simple referrals. However, the association believes real estate brokers are entitled to remuneration for all services performed in the sale of a home, provided the fees are fully disclosed, and that use of the services is not required.

The ability of real estate brokers to fulfill consumer demand for mortgage location services, and their right to collect a fully disclosed fee for doing so, was discussed in a recently published federal regulation implementing the Real Estate Settlement Procedures Act (RESPA).

The regulation was released by the U.S. Department of Housing and Urban Development (HUD), the department charged with RESPA enforcement. NAR is very pleased that HUD reinforced the association's position on CLO systems. HUD correctly backed our contention that the systems can benefit consumers by providing a wide choice of mortgages, interest rates and loan terms -- all in the convenience of the real estate broker's office. Facilitating the use of CLO systems in real estate offices is a progressive response to what is clearly a consumer issue. Home loan choices will be opened up, not stifled.

HUD's action put an end to the regulatory vacuum that imposed unnecessary restraints on the ability of businesses to compete freely in the marketplace. In the RESPA regulation, HUD ratified the fees-for-services payment to real estate brokers using CLO systems. RESPA prohibits payments for simple lender referrals. However, the law clearly allows the collection of fees for actual services rendered; and HUD's regulation affirms this.

The RESPA regulation will allow CLO systems to progress as dictated by consumer needs. As a result, regional and area CLO systems likely will emerge. In fact, it is quite possible that localized systems will evolve that serve individual housing markets in a manner similar to multiple listing systems. Such systems could be tailored to specific needs of individual real estate markets. The consumer can only benefit.

Opponents of our position have erroneously charged that real estate brokers tend to refer buyers only to lenders who pay the highest fees, regardless of quality of product or service. This simply is <u>not true.</u> The more options provided, the sooner a buyer can obtain financing that best suits his needs, and the sooner a transaction can be closed. It serves no one's interest for a broker to restrict buyers to lenders on a CLO system. The systems are for use by consumers only if they choose to do so. Real estate brokers want buyers to come back when they're ready to sell. Sales commissions are worth a lot more to brokers than collecting a nominal fee for CLO operations. No real estate

agent is going to sacrifice a future commission by trying to persuade a buyer to use a lender on a CLO system.

Opponents of expanded CLO systems have also claimed that the collection of fees from buyers for mortgage assistance creates a conflict of interest for agents contracted by sellers. Again, this is completely false. A broker who helps a buyer obtain financing to buy the seller's home is helping to close a transaction. No seller is going to object to that. Full, written disclosure of all the services and fees involved in a transaction, issued in advance to all parties, provides adequate protection from conflict-of-interest problems.

Today's consumers are short on time. Home buyers don't want to run around to a real estate broker to see listings, to a mortgage company to get a loan, then to a title company for title insurance. Multiple-service, diversified real estate offices provide an easier, faster way to sell a home.

In short, CLO systems give consumers what they want when they want it.

###

## LIST OF RESOURCES

| | |
|---|---|
| NATIONAL ASSOCIATION OF REALTORS® | |
| Library in Chicago | 312-329-8292 |
| The Department of Housing and Urban Development (HUD) | |
| RESPA Enforcement Unit | 202-708-4560 |
| Office of the General Counsel | 202-708-9985 |
| NATIONAL ASSOCIATION OF REALTORS® | |
| Sally Sciacca, Government Relations | 202-383-1078 |
| Steve O'Connor, Government Relations | 202-383-1117 |
| Robert Nickens, State Information | 202-383-1201 |
| Mary Stark-Hood, Legal Affairs Department | 312-329-8374 |
| CLO Vendors (NAR Library) | 312-329-8292 |

# ATTACHMENT A

Attachment A

Federal Register / Vol. 57, No. 212 / Monday, November 2, 1992 / Rules and Regulations 49623

APPENDIX E TO PART 3500 -

CLO FEE DISCLOSURE

Instructions: Whenever it is anticipated that a fee will be paid by the borrower for CLO access and related services, a disclosure form must be fully completed and delivered to the borrower itemizing the services provided and the specified fee to be charged as well as the other information set forth below. The form must provide a place for the purchaser to acknowledge its receipt. The disclosure format set forth below is satisfactory to the Secretary.

<u>CLO FEE DISCLOSURE</u>

To: [Potential Borrower] From: [Person Making Disclosure]

NOTICE: I am proposing to charge you a fee in the amount of $_____________ for the following services:

[ ] Displaying a variety of mortgage loans and rates which may be available to you.

[ ] Counseling you regarding the different types of loans available and the relative rates in a fair and equitable manner.

[ ] Relating your personal housing needs with available loan programs; and assisting you in deciding which, if any, loan meets your needs.

[ ] Entering information regarding you into the Computer Loan Origination System (CLO).

[ ] Other_______________________________________

_______________________________________________

THIS IS TO INFORM YOU THAT YOU ARE PAYING THIS FEE DIRECTLY TO <u>[Person or Company Making Disclosure]</u>.

YOU ARE ADVISED THAT YOU MAY AVOID THIS FEE ENTIRELY IF YOU APPROACH A LENDER OR MORTGAGE BROKER DIRECTLY. ADDITIONALLY, LOWER MORTGAGE RATES OR OTHER LOWER FEES MAY BE AVAILABLE FROM OTHER MORTGAGE LENDERS WHO ARE NOT LISTED ON THIS COMPUTER SYSTEM.*

I hereby pay [commit to pay] a CLO Fee in the amount of $__________.

______________________________
Borrower

Received by: ______________________________

BILLING CODE 4210-27-C

* Where the lender is requiring an attorney, credit reporting agency or real estate appraiser to represent its interests, this paragraph should be omitted.

# ATTACHMENT B

70-043 0 - 94 - 8

Attachment B

49622 Federal Register / Vol. 57, No. 212 / Monday, November 2, 1992 / Rules and Regulations

APPENDIX D TO PART 3500 -

CONTROLLED BUSINESS ARRANGEMENT DISCLOSURE STATEMENT FORMAT

Notice

To: Buyer or Seller ______________________ Property:

______________________

From: [Entity Making ______________________ Date:

Statement]

This is to give you notice that ___[referring party]___ has a business relationship with ___[provider]___. [Describe the nature of the relationship between the referring party and the provider, including ownership and financial interests.]

Set forth below is the estimated charge or range of charges by _[provider]_ for the following settlement services:

______________________: $______________________

______________________: $______________________

______________________: $______________________

You are not required to use ___[provider]___ as a condition for [settlement of your loan on] [or] [purchase or sale of] the subject property. You may be able to get these services at a lower rate by shopping with other settlement service providers.

A lender is allowed to require the use of an attorney, credit reporting agency or real estate appraiser chosen to represent the lender's interest.

# First Portland announces new buyer's broker services -- free!


Real estate brokers work for the home seller. That's their job. Pure and simple.

We think someone should work for the home buyer. That's why -- in addition to the lowest rates and most mortgage products -- First Portland Mortgage now offer's buyer's broker services* -- *at no charge for First Portland customers!*

Our loan officers are also licensed real estate agents. We will act as your advocate, and guide you through the entire house-buying process. For mortgage pre-approval to offer to contract to inspections to closing, we'll represent you every step of the way. Please give us a call today! Ask about our low rates, and for a free copy of our brochure 13 Tips for Home Buyers. At First Portland Mortgage we work for the buyer!

First Portland
Maine's Mortgage Specialists

1321 Washington Avenue, Portland, Maine 04103
1-800-370-5222 878-7770

## Mortgage company finds a way to stand apart

As anyone who has shopped recently for a mortgage knows, there isn't a whole lot of difference in mortgage rates from one company to the next. That's because mortgage rates are market driven and therefore, fairly uniform.

That leaves mortgage companies scrambling to distinguish themselves from the pack. Edward van Loenen, president of First Portland Mortgage, says he's found a way, offering brokerage services to home buyers.

By doing so, van Loenen has turned the traditional relationship between brokers and lenders upside down. Typically, brokers match buyers to homes and then refer them to a lender.

With van Loenen's Portland company, the lender qualifies the buyer for a mortgage and then brings the buyer to the listing broker. Once negotiations begin, First Portland's loan officers/real estate agents will represent the buyer's interests.

Van Loenen says this new arrangement was made possible by a change last year in the federal real estate settlement procedures act which now permits real estate companies to become lenders and lenders to act as agents.

INDEPENDENT FINANCIAL ASSOCIATES

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- WHOLE LIFE
- UNIVERSAL LIFE
- MODIFIED LIFE
- SINGLE PREMIUM LIFE
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- MORTGAGE & CREDIT LIFE

- Over 75 Life Products

## SECURITIES

- MUTUAL FUNDS (93 FUND FAMILIES)
- VARIABLE ANNUITIES (3) PRODUCTS
- UNIT INVESTMENT TRUSTS
- QUALIFIED RETIREMENT PLANS

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| IRA | SEP |
| 403(b)(7) | SARSEP |
| 401(k) | Keogh |

Securities offered through SunAmerica Securities, Inc
8024 Alico Road, Suite A-7, Ft. Myers, FL 33912
(813) 267-2323

## BUSINESS SERVICES

- PAYROLL/TAX FILING
- BOOKKEEPING
- WORKERS COMPENSATION
- TAX PREPARATION
  - PERSONAL
  - BUSINESS
- BUSINESS INSURANCE

## HEALTH INSURANCE

- MEDICARE SUPPLEMENTS
- LONG TERM CARE
- INDIVIDUAL MAJOR MEDICAL
- GROUP INSURANCE
- DENTAL PLANS
- DISABILITY INCOME

- Over 50 Health Products

## PROPERTY & CASUALTY

- AUTO HOMEOWNERS
- FIRE INSURANCE
- LIABILITY INSURANCE
- AVIATION & MARINE

- Through 17 P&C Companies

## ESTATE PLANNING

- LIVING TRUSTS
- WILLS
- LEGAL SERVICES
- LIVING WILLS

## ANNUITIES, FIXED

- IMMEDIATE & DEFERRED
- TAX SHELTERS
- GUARANTEED PRINCIPAL
- GUARANTEED RATES
- BAIL OUT PROVISION

- Over 10 Annuity Products

## MORTGAGES

- FIRST
- SECOND
- COMMERCIAL
- ACCELERATION
- EQUITY LOANS
- CONSOLIDATION LOANS

- Through IFA Mortgage
  LIC MTG BKR, E.O LENDER

## REAL ESTATE

- FULL SERVICE
- BUYERS BROKER
- OWNER ASSIST
- PROPERTY MANAGEMENT
- REAL ESTATE TRUSTS

- Through IFA Real Estate
  LIC REAL BKR, E.O HOUSING

**Mortgage Bankers Association of America**

1125 15th Street N.W.
Washington D.C. 20005-2766
Tel (202) 861-6500

The National Association of Real Estate Finance

MBA

STATEMENT OF

Herbert B. Tasker, CMB

Chairman of the Board & C.E.O.

All Pacific Mortgage Company

on behalf of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

**Hearings on**

**RESPA--The Real Estate Settlement Procedures Act**
**Implementation of Computerized Loan Origination Systems and**
**Controlled Business Arrangements**

**July 1, 1993**

Mr. Chairman and Members of the Committee, I am Herbert B. Tasker, Chairman of the Board & C.E.O. of All Pacific Mortgage Company, located in Concord, California. I am also currently serving as President of the Mortgage Bankers Association of America (MBA).[1] Accompanying me today are Michael J. Ferrell, MBA's Senior Staff Vice President and Legislative Counsel, and Sharon M. Canavan, MBA's Deputy Legislative Counsel.

MBA appreciates the opportunity to appear before you today to testify with respect to the Real Estate Settlement Procedures Act (RESPA) and the growing proliferation of referral fee programs via computerized loan origination (CLO) systems and controlled business arrangements (CBA). These activities were authorized by regulations issued by the Department of Housing and Urban Development (HUD) that became effective on December 2, 1992, pursuant to regulations published just prior to the election on November 2, 1992. Because others on the panel are addressing the issue of controlled business arrangements, MBA is focussing its comments on computerized loan origination systems.

RESPA is a housing issue and RESPA is a consumer issue. MBA is deeply concerned over the proliferation of mortgage referral fee programs that are undermining the integrity of the mortgage lending process and adding to the cost of housing. People are paying too much for their homes when unnecessary referral fees are built into closing costs or are added to the lifelong cost of a mortgage.

Mortgage lending has become a highly complex, sophisticated, and competitive business. Lenders across the country can offer programs with many new features that create significant benefits to homebuyers and borrowers. Both referral fees paid by borrowers for CLO services and controlled business arrangements, as permitted under the December regulations, will undermine that competitive environment by introducing inducements into what should be an open process.

Inducements in the form of fees to real estate brokers/agents lead to the steering of potential borrowers to a single lender or set of lenders who are participating in computerized loan origination programs where real estate agents/brokers charge borrowers directly for unspecified loan/financing services. Steering that is motivated by a fee means that the borrower may not be getting the best advice about financing. And allowing that fee to be paid at closing rather than when the service is provided allows the fee to be "hidden" in the myriad of other fees paid at closing.

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**[1] The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of residential and commercial real estate finance. MBA's membership comprises nearly 2,500 mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios.**

**Members of MBA include:**

- **Mortgage Banking Companies**
- **Commercial Banks**
- **Mutual Savings Banks**
- **Savings and Loan Associations**
- **Mortgage Insurance Companies**
- **Life Insurance Companies**
- **Mortgage Brokers**
- **Title Companies**
- **State Housing Agencies**
- **Investment Bankers**
- **Real Estate Investment Trusts**

**MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; Telephone: (202) 861-6500.**

Real estate brokers/agents are in a unique and controlling position, with considerable influence over the homebuyer's financing decision. Their recommendation should be based on the best combination of interest rate, terms, and services--not on the potential to earn a referral fee paid by the borrower.

Perhaps the most alarming aspect of the regulation is that what precisely constitutes a computerized loan origination (CLO) system and what service must be provided are undefined. A fee can be charged to the borrower even if the real estate broker/agent has a prearranged agreement to refer borrowers to a limited list of lenders or even a single lender. The borrower who pays for this service is not assured of receiving objective advice.

Prior to the enactment of RESPA, many real estate transactions involved non-competitive practices. The payment of kickbacks and referral fees in order to steer customers to a particular mortgage lender, title search or insurance firm was commonplace. RESPA was enacted to eliminate these practices.

But the recent HUD regulation has reopened the door to paying referral fees. As the practice of paying referral fees spreads, many lenders feel they have no choice but to participate in the CLO programs that many real estate brokers/agents are demanding, if the lenders want continued access to customers.

As a direct result of the publication of these regulations, there has been a proliferation of kickback programs. Furthermore, there has been a dramatic increase in real estate brokers/agents demanding blatant kickbacks for referral of business, which are a clear violation of RESPA, because the HUD regulations are not specific regarding what precisely constitutes a CLO system.

### *Legislative Background*

The Real Estate Settlement Procedures Act was enacted in 1974. (Attachment A provides a chronology of RESPA legislative and regulatory actions). It provides among other things a prohibition against certain kickbacks and unearned fees in real estate settlement transactions. The Act has two major purposes in this regard:

1. To inform consumers about settlement costs and services, and

2. To protect consumers from excessive settlement costs and, when possible, reduce settlement costs. Section 2 of the Act, "Findings and Purpose" states the following:

> (a) The Congress finds that significant reforms in the real estate settlement process are needed to ensure that consumers throughout the Nation are provided with *greater and more timely information on the nature of costs of the settlement process and are protected from unnecessarily high settlement charges caused by abusive practices.* (Emphasis added.)

Prior to the enactment of RESPA, many real estate transactions involved non-competitive practices. The payment of kickbacks and referral fees in order to steer customers to a particular firm for title search and insurance, and other services was commonplace in some parts of the country. Section 8 prohibits giving or receiving a "fee, kickback, or thing of value" for referring a borrower to any particular settlement service provider.

Nowhere in RESPA or its legislative history is there any indication that Congress believed that a referral fee, direct or indirect, can be acceptable if it is disclosed. To the contrary, Congress created RESPA's Section 8 to eliminate all kickbacks or referral fees because such payments "tend to increase unnecessarily the cost of certain settlement services" (Section 8(b)(2)). It should be noted that Congress did not require that a payment to be prohibited must in fact be one that increases settlement costs. All such payments are prohibited because they "tend to" increase settlement costs.

These principles are as important today as they were in 1974. We believe that any new mortgage origination programs should be encouraged as long as they adhere to these principles. Our concern is that HUD has approved programs that violate these basic consumer protection principles.

## *HUD's Actions*

Beginning in 1986 HUD approved certain specific referral fee programs, mainly through the issuance of "private opinion letters." The HUD-approved programs were of two basic varieties:

(1) Borrower Pay. Even though the real estate brokers/agents have a pre-arranged relationship with lenders, HUD has stated that real estate brokers/agents can collect fees from borrowers for referring them to lenders. It is not required that loan processing or other work be performed by the real estate brokers/agents.

(2) Lender Pay. HUD stated that lenders can pay real estate brokers/agents fees for services rendered and expenses incurred (known as "work performed"). Specifically, concerning computerized loan origination systems, HUD approved the payment of fees to cover computer costs. These fees can be paid based on the volume of loans referred without regard to the actual computer service cost.

HUD published on May 16, 1988 proposed revised and amended RESPA regulations for comment. This proposal was published after five years of delay, to implement Congressional amendments enacted in 1983. Those amendments involved "controlled business arrangements" and did not address referral fees outside of that context. In the proposed regulations, HUD went beyond responding to the 1983 amendments and included a "borrower pay provision" that would allow fees to be paid by the borrower to a real estate broker/agent for a pure referral to a lender. HUD received over 2,000 comment letters in response to the proposal. Most of the comments on the borrower pay provision strongly opposed it.

A draft final rule dated December 7, 1988 was prepared and became widely circulated. That draft changed the position HUD had taken previously both in "private opinion letters" and in the May 1988 proposal. On the issue at hand, the preamble to the December 7 draft stated in relevant part:

> "Eight hundred and forty commenters opposed the borrower pay provision. The borrower pay provision was strongly opposed by virtually every trade association, such as the Mortgage Bankers Association, U.S. League of Savings and Loan (sic) Institutions and the National Council of Savings Institutions."
>
> "In response to the comments received, the borrower pay mortgage broker concept was reviewed in detail by the Offices of the FHA Commissioner and the General Counsel. It was decided that a borrower should be able to seek out an independent entity, uninvolved in the settlement transaction, to assist the borrower in locating a lender and obtaining financing. It was concluded, however, that the arrangement (previously approved by

HUD)...materially altered this straightforward borrower pay mortgage broker concept. ...the person receiving the...fee from the borrower...was often a real estate broker who was also receiving a sales commission from the seller. As a consequence, the Realtor was placed in a conflict of interest situation in which he was able to shape the terms of the sales contract, particularly the financing terms, to assure the expeditious closing of a real estate sale, in order to earn a sales commission, and to exert influence to direct the use of one lender over another, as well as potentially generating a referral fee paid by the borrower. The borrower had not in actuality voluntarily chosen to be assisted by an independent party to obtain a mortgage loan but rather was in a position of being influenced by the Realtor to choose a particular lender in part to serve the Realtor's own purposes. It was further recognized that under such a borrower pay arrangement, the parties could easily manipulate points and charges in such a way as to disguise referral fees; the borrower after all, was the sole funding source for all charges in the closing transaction."

"For these reasons it was determined that to preserve the legislative intent of RESPA to prohibit referral fees, HUD would withdraw the overbroad borrower pay mortgage broker provision set in the proposed rule and return to the original concept of an independent mortgage broker uninvolved in the settlement transaction..."

In the controlled business portion of the regulation, HUD also added language, which had not been in the proposed rule, to make it clear that "an entity [may not] pay its own employees to refer business to an affiliated entity."

This final rule, though it was drafted and approved by HUD staff and apparently was recommended for publication by the Assistant Secretary for Housing and the General Counsel, was never approved for publication by former Secretary Pierce.

When HUD Secretary, Jack Kemp, took office in 1989, he was confronted with a number of problems and did not place a priority on the RESPA regulations. However, the HUD staff continued their work and prepared a number of drafts of a final RESPA rule under the direction of the new General Counsel, Frank Keating.

The Kemp administration seemed to be in general agreement with the December 1988 draft rules and Frank Keating even went further than the draft rules when he testified before Congress in September 1990, articulating HUD's position. He stated that, in order to balance the benefits of CLOs against their potential for harm to consumers, HUD would require that all real estate agents who offer CLOs (i) be required to offer the products of multiple lenders; (ii) disclose to borrowers that they will be charged a fee for the CLO service; and (iii) disclose to borrowers that there are other lenders not on the CLO system that may provide more favorable loan terms. HUD would also require that fees, if any, be capped at a fixed dollar amount set to reflect the reasonable cost of providing CLO services.

On January 3, 1991, HUD prepared another draft final rule that was widely circulated. That rule embodied much of the December 1988 draft and the General Counsel's testimony. It also proposed a specific cap on CLO fees of $250.

On November 2, 1992, HUD issued a final RESPA rule. Without warning or explanation, HUD reversed itself on both the CLO provisions and the payment of fees to employees in a controlled business arrangement. The regulation expressly permits "[a]ny payment by a borrower for computer loan origination services" so long as disclosure is made. HUD provides no definition of a CLO, no cap on fees and no requirement that the CLO be open to more than one lender. The regulation also expressly permits an employer in a controlled business setting to pay its employees a bonus when the employees refer settlement business to an affiliate.

## *Problems with Mortgage Referral Fee Programs*

HUD's own staff text, quoted above from the draft final regulation, captures well the inherent conflict of interest in allowing real estate brokers to receive a mortgage referral fee either from the lender or the borrower. It is fundamentally wrong for a real estate broker, who is receiving a substantial commission from the seller of a home, to have a financial interest in where the buyer of the home gets a mortgage. More specifically, referral fees add to the cost of housing, are unnecessary, distort the market and should be prohibited.

MBA urges Congress and the Department of Housing and Urban Development (HUD) to adopt an interpretation of RESPA that would combat current and future abuses of the consumer protection provisions in that statute by taking a position that would prohibit the payment of referral fees by borrowers or by lenders, in connection with the making or processing of a mortgage, to a person who is receiving a commission premised upon the sale of the real estate which is the subject of that mortgage, whether or not work is performed by that person.

At a minimum, if fees are allowed to be paid by borrowers to real estate agents/brokers for computerized loan origination services, the service should cover products offered by multiple lenders, the fees should be paid at the time that the service is provided, not at settlement, and the fees should be capped at a reasonable level, such as the $250 suggested by HUD at the time of General Counsel Francis Keating's testimony before Congress in 1990.

If lenders are allowed to pay fees in connection with a CLO, the fees should be strictly limited to actual work performed, should be directly related to the value of the service rather than the value of the referral of business, and should not be paid to anyone receiving another fee in the transaction.

## *Why Referral Fees Should Be Prohibited*

**1. Referral fees discourage competitive mortgage pricing.**

Lenders traditionally get business through referrals from brokers/agents. As a result of the December 1992 regulations, brokers/agents are developing exclusive or limited arrangements with lenders, who will participate on CLO systems that permit the real estate agent/broker to charge fees to borrowers.

Of particular concern to MBA are instances where brokers/agents have refused to accept information from independent lenders or provide information to borrowers about other lenders who may provide better financing terms for buyers.

With the spread of these programs, market forces are distorted because the fee payment becomes the overriding consideration in the mortgage selection process (instead of a lender's pricing, quality of service, reputation). When non-CLO system lenders are denied open access to the buyer, that buyer does not have adequate information about better alternative services. Regardless of the competitiveness or attractiveness of a lender's rates, fees, or the quality of its service, buyers may be steered only to those lenders participating on the CLO system.

As fees escalate, becoming a payment for the referral rather than for actual work performed, and more lenders are forced to pay fees to compete, larger lenders have the financial and technological capacity to dominate CLO systems, and many smaller lenders will be unable to compete and will be driven out of the business. Once this occurs, the marketplace will be considerably less competitive and borrowers will have fewer financing options.

Referral fee programs close markets and reduce competition. All lenders should have open access

to the market and to borrowers, and this access should not be based upon whether or not a fee is paid to the real estate agent/broker for providing financing information or completing an application form.

**2. Referral fees raise quality control concerns and the risk of mortgage defaults.**

The major source of compensation to a real estate broker/agent is the sales commission paid at loan closing. In order to expeditiously close the loan, the temptation is there for the broker/agent to present information in ways that make it more likely that an unqualified borrower will be approved for financing and more likely that the broker/agent will receive his commission sooner. Allowing individuals who already have a vested interest in seeing a loan closed to become involved in the mortgage origination process seriously compromises the lending decision. History has taught the industry an expensive lesson from problems associated with fraud and abuse in the loan origination process.

Federal policies should not support practices that include inherent conflicts of interest that could undermine the stability of a financial institution. If the institution is insured by the Federal Deposit Insurance Corporation or the loan is federally guaranteed, the Federal government is affected by those increased risks.

**3. Referral fees are not payments for work performed or services rendered.**

Some argue that a fee is warranted because there has been "work performed" or "services rendered." MBA believes that this argument serves as a simple guise to justify the payment of referral fees. The disclosure statement in the regulation even permits payment of fees for simply typing in information on an application.

First, lenders need to reverify any information (such as salary, income, bank accounts, credit reports, debts, etc.) provided to them by third parties when making the underwriting analysis, in order to prevent fraud and ensure appropriate quality controls. Information collected by individuals with a vested interest in the closing of a loan should be verified independently to protect the quality of the lender's underwriting decision.

Second, the function provided by the real estate agent in most cases is largely clerical (inputting information into a computer terminal), because the real estate agent provides neither the underwriting analysis nor a willingness to stand behind the information provided as true and correct. Real estate agents are not willing to indemnify a lender in the event that the loan enters default. Indemnification in mortgage lending is required to ensure against either an error in the information provided or even outright fraud that might lead to faulty underwriting and ultimately a default. FHA, FNMA, and FHLMC aggressively pursue lenders to indemnify losses where underwriting errors have occurred or fraud has been committed.

Third, a computerized listing of lenders, rates, and mortgage products may be of some value to the consumer, but is of little added value more than is now provided for free in the form of rate sheets made available by lenders at the real estate broker/agent's office. The ability and legal responsibility to stand behind the information as true and correct is the service that deserves compensation. The clerical function of completing the application form warrants little, if any, compensation.

**4. Referral fees raise the cost of housing.**

Fees paid by borrowers to real estate agents for locating financing are unnecessary. These services have traditionally been regarded as one of the services brokers/agents provide in order to consummate a transaction. Work performed by a real estate agent in helping a buyer obtain

financing is work performed for the benefit of the real estate agent's sole client, the seller. Indeed, in the typical presentation that the real estate agent makes to a prospective listing seller, pre-qualification of prospective buyers and helping the buyer obtain financing are usually services specified to justify the commission. To charge the borrower for this assistance, as well as the seller, merely raises the total cost of housing.

**5. Referral fees encourage adverse steering.**

Allowing referral fees to be paid will increase the real danger that referrals will be made only to lenders participating on the computerized loan origination system. Instead of helping the borrower find the best financing arrangement as part of their service to the seller, real estate brokers/agents will be encouraged to steer borrowers to lenders participating on the system.

Most unsophisticated buyers rely heavily on referrals made by real estate agents and can easily be manipulated to benefit the real estate agents. This is particularly troubling, because of the close working relationship that develops between the potential borrower and the real estate agent who has helped to find a home.

**6. Referral fees pose a conflict of interest for the real estate broker/agent**

When a buyer uses the services of a real estate broker/agent, the real estate broker/agent's fiduciary duty is to the seller, not the buyer. The real estate broker/agent fulfills part of his or her fiduciary obligation to the seller by assisting the buyer in obtaining financing in order to facilitate the sale of the seller's home. Thus, the provision of information to buyers about a lender's loan products should be viewed as the normal type of service that real estate brokers/agents provide. This service may or may not be in the best interest of the buyers.

If a buyer (or lender) pays a fee to the real estate broker/agent for assistance in locating financing, this fee raises an inherent conflict of interest because the real estate broker/agent then has a dual obligation to act for both the seller and the buyer (or lender). In many instances, the best interests of both parties may conflict. For example, because of the seller's desire to close quickly, a real estate broker/agent would be motivated to find a lender with the fastest processing, even though the terms of the loan are not in the buyer's best interest (or the broker/agent could present information to the lender in ways that make it more likely a marginal buyer will be approved for financing).

The Realtors' own Code of Ethics recognizes the need to address this kind of conflict when it states in Article 7:

> In accepting employment as an agent, the REALTOR pledges himself to protect and promote the interests of the client. This obligation of absolute fidelity to the client's interests is primary, but it does not relieve the REALTOR of the obligation to treat fairly all parties to the transaction.

The obligation to be fair to all parties surely must be strained when the broker/agent is accepting a fee from more than one of them. As one who refused to participate in a kickback program was quoted as saying: "This is not just a legal issue, it's a moral issue."

**7. Referral fees are unnecessary for technological innovation or rapid loan processing.**

Some have argued that referral fee programs are a part of modern-day mortgage delivery technology. By involving real estate brokers/agents in the mortgage application process and compensating them accordingly, it is possible, some argue, to streamline processing and shorten the time it takes to make loan commitments and close loans.

We disagree. For decades, real estate brokers/agents have provided assistance to homebuyers in shopping for a mortgage without asking for additional compensation. Today, highly sophisticated and successful computerized loan origination systems are in use by many firms and computer technology is an integral part of all modern mortgage lenders' business. Many lenders can provide computerized information on types of loans available and their costs. They can also provide rapid underwriting and loan approvals for those needing this service, and they can perform many of these functions at a borrower's home or in the offices of real estate brokers/agents. These services can be and are being provided by reputable firms without the payment of additional fees.

MBA is not opposed to computerized loan origination systems where a borrower is offered a choice of loan programs on a computer screen. However, that choice should not be restricted to programs offered by lenders who are willing to participate in a referral fee CLO program. That is the *illusion* of choice. Borrowers who are referred to these lenders, unless they read and fully understand the disclosures, are unaware that other lenders outside this closed system may be offering more competitive rates.

The use of computerized loan origination systems is a time-saving innovation that can result in lower costs. These cost savings should be passed on to consumers and not used as an excuse to add another layer of costs by paying real estate agents/brokers an extra fee for functions that should be undertaken by trained underwriters who are accountable for loan quality.

There is a clear danger that CLO systems will choke off the access of lenders to consumers. If this happens on a widespread basis, independent lenders who have *not* developed exclusive arrangements with real estate brokers/agents or who do *not* participate in schemes to provide those real estate brokers/agents payments in addition to their sales commission fees, will not get referrals. Without referrals, those businesses will close and will no longer be a competitive force to keep mortgage rates and real estate settlement costs competitive.

Computers have brought great conveniences to modern day life. Yet they should not be used as excuses to increase expenses, but as devices to expedite loan selection and processing. Because a computer makes a process more efficient it should result in lower costs, not another layer of costs.

As a practical matter, real estate agents have long used "rate sheets" dropped off by mortgage companies at the real estate office. It is no more complex, in fact, it is arguably more convenient for the real estate agent to use a computer screen to select various products than to flip through a file folder of rate sheets.

Thus, the point could be made that while computerized loan origination systems hold the potential for reducing consumer search costs and increasing competition by stimulating the flow of information, past experience has shown that they also hold the potential for seriously harming the interests of consumers through uncompetitive practices.

If CLO systems are established which provide open access to all lenders and are an effective tool in assisting homebuyers to shop among lenders, there may be a justification for the homebuyer to pay a fee for this service. However, the fee should be disclosed and paid at the time the service is rendered and the homebuyer should not be required to use this service in shopping for a loan. The fee should also be capped by HUD regulation to assure that unsophisticated consumers are not charged excessive fees for this service and that the fees actually reflect the value of the work performed and the cost to provide the service.

<u>8. Referral fees are prohibited for FHA-insured loans.</u>

Referral fees are prohibited on Federal Housing Administration (FHA) insured loans. HUD has

taken this position to protect the generally unsophisticated borrowers who use the FHA insurance programs and to keep the costs low on home financing. HUD, in its own FHA home mortgage insurance programs, prohibits certain referral fees. HUD Handbook 4000.2 REV-1 states:

7-5 Prohibited "Kickback" Payments By Approved Mortgagees.

(a) A mortgagee is not permitted to pay any fee, kickback, compensation or thing of value, including a fee representing all or part of the lender's origination fee:

1. To any person or entity other than for services actually performed.

2. To any person or entity for referral of the loan or as a "finder's fee."

3. To any person or entity as a gift or gratuity over and above items that are customarily distributed in the normal course of advertising or public relations operations or as a general promotion device.

4. To any person or entity which has received or is to receive any other payment or consideration for services related to the transaction, except a commission in connection with the sale of a hazard insurance policy at the request of the mortgagor.

5. To any person or entity for assistance in the preparation of the FHA mortgage insurance application if such party owns, is owned by, or is under common ownership with the builder or a person or entity which has received a real estate commission in connection with the transaction.

Because HUD has recognized the need to limit practices that add unnecessary costs to home purchases, it prohibits such fees in its own programs. But the Department has not prohibited them for consumers in the conventional home loan market.

### *MBA's Position*

Many lenders are considering implementing fee programs in order to remain competitive in local markets. Once referral fees become a widespread practice, lenders will have to participate to remain competitive, and the consumer will pay in higher fees and interest rates. Ultimately, the heaviest price to be paid, if referral fees are sanctioned, would be reduced competition. The field would be left to the oligopoly of a few big players--an unfortunate scenario for homebuyers.

MBA's members and leadership have given RESPA issues an unprecedented amount of attention over the past 5 years. We have held numerous meetings on this subject in each of our major residential committees, our Legislative Committee and established special RESPA Task Forces to research the issues and their impact on consumers and the industry. Our Board of Governors on repeated occasions has established firm Association policy. Our consistent position for the past five years and shared by an overwhelming majority of our members is as follows:

MBA supports the concepts of prohibiting referral fees and requiring full and timely disclosure of costs of a real estate settlement transaction. In this connection, MBA believes the making and processing of a mortgage constitutes a settlement service in the framework of RESPA. MBA opposes the payment by borrowers or lenders, of any fees in connection with the making or processing of a mortgage, (1) to a person who is receiving another fee in the transaction, whether or not work is performed by that person, and (2) to a person who does not perform work in the transaction. RESPA regulations should allow the payment of fees to a person who is a bona fide mortgage broker.

MBA supports the disclosure of information relating to any referral. Such disclosure of information should include a description of the relationship, if any, between the parties to the referral transaction and the amount of fee paid, if any. This disclosure should (1) occur at the time, or before, the referral is made and (2) be on a standard form. To the extent that a fee is paid, the fee must be paid voluntarily.

MBA believes that this is an issue that can and should be addressed quickly and effectively by the new HUD leadership. Secretary Cisneros should immediately undertake a thorough review of RESPA issues, focused particularly on the November 2, 1992 regulations and the abuses already beginning to arise from their implementation.

Working within the framework of the November 2, 1992 regulations, HUD should issue amendments to those regulations which would:

1) Revise the computerized loan origination network provisions to:

- ♦ provide a detailed definition of a CLO which would specify that it must be an interactive system which provides open access to multiple lenders;
- ♦ require that borrowers be notified of any fee before the service is performed and notified that the service is not required;
- ♦ require that borrowers pay the fee at the time the service is performed to assure that the fee is not hidden from borrowers in the settlement process;
- ♦ place a cap on the fee paid by borrowers which is commensurate with the work actually performed; and
- ♦ prohibit the payment of fees from lenders to anyone receiving another fee in the transaction.

2) Prohibit companies with controlled business relationships from paying their employees for the referral of business to affiliated companies.

If HUD does not move expeditiously, the Congress should take action to amend RESPA to assure that consumers are protected.

## *Summary*

MBA strongly believes the payment of referral fees or fees for duplicative mortgage origination activities by borrowers or lenders to real estate agents should not be sanctioned. RESPA was enacted to prohibit the payment of referral fees and this practice should not be allowed to resurface. Allowing referral fees will: create ethical problems where conflicts of interest exist; exacerbate the potential for fraudulent documentation where persons other than the lender collect financial information; reduce marketplace competition; and add another unnecessary layer of fees to real estate transactions at a time when mortgage affordability is an increasing concern.

MBA appreciates the opportunity to testify before this Committee and will provide answers to questions or requests for additional information, as requested, for inclusion in the hearing record.

## Attachment A

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA):
A CHRONOLOGY

**1974** **RESPA Enacted**.

RESPA Section 8 designed to provide consumers involved in real estate settlement transactions with timely information regarding the nature and costs of the settlement process.

Intended to protect consumers from unnecessarily high settlement costs caused by certain practices, such as kickbacks or referral fees.

Section 8, a. "No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."

b. "No person shall give and no person shall accept any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed."

**1983** **Department of Housing and Urban Development v. Graham Mortgage Company**

The U.S. 6th Circuit Court of Appeals overturned a lower court decision in Michigan and decided that given the ambiguity in the statute, for purposes of criminal prosecution the making of a mortgage loan was not a settlement service, so providing a thing of value for the referral of a loan was not a violation of the anti-kickback provision of RESPA.

HUD disagreed with the Court's ruling that the making of a mortgage loan did not fall under the purview of RESPA as a settlement activity. Outside of the 6th Circuit (Kentucky, Michigan, Ohio, Tennessee), HUD continued to consider mortgage loans as settlement activities under RESPA and barred kickbacks, fees or the receipt or giving of things of value for the referral of loans.

**1984** **HUD Informal Opinions**

Lender Pay Programs

First informal opinion rendered by HUD permitting lender payments to real estate brokers involved in computerized loan origination systems (CLOs). These programs are also known as "lender pay programs."

HUD determined that in the case of computerized loan origination systems, lenders paying fees to the real estate brokers for referring loans through the system was actually for "work performed," the use of computer time, and was permissible, even if, as MBA asserted, the fee paid bore little resemblance to actual cost of computer time.

**1986 HUD Informal Opinion**

Borrower Pay Program

The HUD General Counsel issued an opinion that fees paid by borrowers to real estate agents for referral to lenders did not violate RESPA, even where the real estate agents had pre-arranged agreements to make referrals only to a specified lender or lenders.

**1988**

**May HUD Publishes Proposed Amended RESPA Regulations for Comment**

The proposed regulations

Addressed the Graham decision by specifically noting that the making of a mortgage loan was a settlement service.

Reaffirmed its earlier informal opinions that "borrower pay" and "lender pay" programs were acceptable under RESPA.

Considered an expanded exemption for payments by lenders to persons who have brought the borrower and lender together.

**July MBA Issues Comment Letter to HUD. Key Points Include:**

Real Estate agents should not be allowed to receive a fee related to a mortgage application or origination. Real estate agents should not have a financial interest in where borrowers get a loan.

The proposal to exempt mortgage brokers from RESPA's Section 8 prohibition of borrowers paying fees to those bringing borrower and lender together, as well as a 1986 opinion by the HUD General Counsel effectively allowing real estate agents to charge borrowers referral fees, should be rejected.

RESPA prohibits all referral fees, and that regardless of who is paying and who is receiving, such fees will cost borrowers more.

**July HUD RESPA Regulation Comment Period Ends**

HUD receives more than 2,000 comment letters.

**October HUD Approves Policy Asking Congress for Legislation**

Policy resolution calls for federal legislation to clarify RESPA prohibition of referral fees.

**December HUD Develops Proposals for Final Rule on RESPA and Referral Fees. Major Points Include:**

The making of a mortgage loan constitutes a settlement service covered by RESPA.

A person or party otherwise involved in the transaction (for example the real estate agent) may not receive a fee to bring the borrower and lender together.

A mortgage broker may receive a payment from a lender or borrower for assistance in bringing the lender and borrower together, provided that no other fees are received as a result of the closing transaction. Fees paid to a mortgage broker under this mortgage broker exception must be described on both the good faith estimate and the HUD-1 Uniform Settlement Statement.

CLOs are permissible under the rule. The owner of a CLO may be compensated by the lender or borrower; however, a real estate agent receiving another fee in the transaction may not receive a fee for assisting the borrower in using a CLO system.

**1990** **HUD Testifies Before Congress on RESPA Referral Fees**

August HUD General Counsel testifies before House Housing Subcommittee and advocates a regulation that would allow a borrower to pay a fee up to a HUD-imposed limit, so long as the disclosures were made at the time the service was rendered and the fee would be paid by the borrower at that time as well.

**1992** **HUD Publishes Regulations on CLOs and Controlled Business Arrangements**

November Immediately prior to the 1992 Presidential election HUD publishes a final regulation for effect in 30 days, which: 1) allows borrowers to pay fees for utilizing computerized loan origination systems and 2) provides for compensation by an employer to an employee in controlled business arrangements.

December HUD regulation published in November becomes effective.

**1993** **Congress Asks New Administration to Review RESPA Regulations**

March Chairmen Gonzalez, Riegle, and Sarbanes sign letter to HUD Secretary Cisneros requesting a review of the RESPA regulation published at the end of the previous Administration.

# *LENDER DUTIES/RESPONSIBILITIES: WHAT THEY DO*

- **Prequalifies Applicant**
- **Assess a Full Range of Mortgage Products and Matches to Borrower Needs**
- **Completes Loan Application**
- **Completes Data Collection to Comply with Fair Housing Act & HMDA Reporting Requirements**
- **Explains Required Documents to Applicant**
- **Explains Rights and Obligations of Borrower Including Disclosurres and Other Requirements of TIL, ECOA, and RESPA**
- **Orders Appraisal and Credit Report**
- **Initiates Verification of Employment and Deposit**
- **Ensures Compliance with Privacy Act and Fair Credit Reporting Act**
- **Explains Flood Insurance Compliance Requirements to Applicant**
- **Locks in Interest Rate**
- **Maintains Ongoing Accountability for Loan Quality**
- **Reviews Loan/Credit Data & Makes Decision on Approval of Loan**
- **Maintains Ongoing Communication with Borrower Regarding Loan Progress**
- **Undertakes Quality Control Review**
- **Takes Marketing Risk**
- **Assumes Liability**

**Testimony of GE Capital Mortgage Corporation**

**House Small Business Committee**

**July 1, 1993**

Mr. Chairman, I am Ray Sims, Senior Vice President of GE Capital Mortgage Services--Residential Express Division of Cherry Hill, New Jersey. My company is a subsidiary of GE Capital Mortgage Corporation, which is involved in many aspects of the mortgage business. My career has been as a mortgage banker, and GE Capital Mortgage has been an active member of the Mortgage Bankers Association of America. I am pleased to be here to testify on the implications of technology and the Real Estate Settlement and Procedures Act rule.

As you know, the isolation of neighborhoods and the segregation of people from the mainstream of communities is an important aspect of our problem of distressed neighborhoods. Many families in urban and rural areas do not have access to the kinds of services-- including financial services-- that the rest of us take for granted. Often we have found that underserved neighborhoods are not connected to the mainstream mortgage community as well. At the same time, there are resources in underserved neighborhoods-- community groups, non-profits, churches, real estate agents, financial institutions that can act as ready and willing partners for mainstream participants.

What has GE Capital done as a corporation? GE Capital Mortgage is acting as a principal link between the neighborhood and the mainstream mortgage system, and we are bringing substantial private sector capital to residents of underserved neighborhoods and communities. In doing so we have sought to utilize the latest computerized loan origination technology. Indeed, CLO capability is an essential link in our outreach program, and a principle reason why I am here today is to illustrate for you how CLO's can be used to bring mortgage services to urban and rural communities which are currently underserved.

We are in the business of helping people buy homes-- particularly those who cannot afford a large downpayment. The heart of GE Capital Mortgage is one of our country's largest mortgage insurance companies. In that business, we insure lenders in the

event that borrowers who buy homes with a low downpayment do not repay their mortgage. Without us, many of these families could not qualify for a mortgage.

Our affordable housing initiatives have been developed in four critical areas:

- Helping families in urban and rural neighborhoods buy homes with low downpayments;
- Making mortgage money available to minority and community financial institutions;
- Rehabilitating and selling foreclosed and abandoned homes;
- Sharing the risk of mortgage defaults with local and state housing programs.

We have developed a number of innovative mortgage products, working in partnership with community and non-profit groups, lenders, secondary market agencies, minority real estate agents, and minority and community financial institutions.

Our Community Home Buyer's Program began with a five city demonstration and led to the successful national program designed for creditworthy borrowers who might not otherwise qualify for a loan.

Under this program, GE agrees to insure loans originated by lenders under more flexible underwriting guidelines, and Fannie Mae and Freddie Mac agree to purchase the loans in the secondary market.

For homebuyers, the program reduces the income and downpayment needed to qualify for a mortgage. With a downpayment of only 3 percent from the buyer's own funds, the remaining 2 percent may be financed by a government agency or non-profit, or a cash gift from a family member. The usual cash reserve requirements are waived and borrowers may establish their credit through non-traditional methods of credit verification such as records of rents and utility payments.

The key to the program's success is the required homebuyer education course which was developed originally for GE by non-profits and community groups. The program is offered in English and Spanish and is constantly being reviewed and enhanced by GE Capital Mortgage Corporation.

To date, GE Mortgage Insurance Company has insured $1.5 billion in loans to over 15,000 lower income families and currently there are 550 financial institutions active in the program. This product is performing well and is one of the best investments our mortgage insurance company has made.

As my colleagues at GE have worked in urban and rural neighborhoods, they have identified other resources that we can bring to expand the availability of capital.

Early this year, we introduced Residential Express, a mortgage network for loan origination. Residential Express provides a full range of support services to assist minority-owned and community financial institutions to offer competitive and flexible mortgage products to their customers. It offers state of the art loan origination technology and software. This allows the bank to counsel its customers on the best possible mortgage options available to them.

We unveiled the program to the National Bankers Association ("NBA") late last year. As you know, the NBA has almost 60 minority member banks located in over 30 states, with assets of $6 billion, servicing over one million depositors.

We have 17 members of the Residential Express network, 14 of which are minority or woman-owned, including African-American, Hispanic, Native American, Asian, and East Indian institutions. Most of these are smaller banks that were not making residential mortgage loans one year ago. If they were making loans, they had a very limited product offering that required at least 20 percent downpayments. Most of these institutions were not connected to the mainstream mortgage system or the secondary market because they lacked the resources and/or the expertise.

Of the 17 banks already active in the network, 12 of them have already registered loans for sale to GE. The banks that have joined the network move quickly to serve the

unmet needs in their communities. The remaining institutions are awaiting our training program.

Residential Express provides a source of fee income to the lender while helping to retain their customers and potentially expand their customer base. These are important economic considerations for community and minority lenders.

Here is how Residential Express works. When a financial institution joins, GE will train the lender's staff at their site on the use of the loan origination software. The computer program performs almost every function you can imagine. It electronically provides loan prequalification, application analysis, immediate feedback on underwriting considerations, and daily mortgage rate information. It provides a tremendous variety of mortgage information to homebuyers on interest rates, points, downpayments and repayment schedules. It even allows the lender to pull a credit report right off the screen for the borrower to review. It allows the lender to discuss with the borrower what he or she needs to do in order to qualify for a mortgage.

While the processing and underwriting may be performed by GE, the loan is closed in the name of the institution and owned by the institution. Loans may be held in portfolio or sold to GE for secondary market sale.

Equally as important, homebuyers are provided access to all of GE's conventional mortgage products, including the Community Home Buyer's Program, and other low downpayment programs. It is critical that underserved neighborhoods have access to all types of mortgage products, both conventional and government-insured.

For example, City National Bank, a small minority-owned bank in Newark, New Jersey made only 3 mortgage loans in all of 1992. Since entering the Residential Express Program on March 1st, they have registered 25 loans: eight in the first three weeks of June.

I am very excited about Residential Express. Although the program only began in February, it is growing at a geometric rate. It has averaged a growth rate of 112% a month in mortgage activity. Mortgage loans of $15,000 and $20,000 have been made while customers who need larger conventional loans up to $200,000 are also being served. Residential Express meets the full spectrum of the community's needs.

We have entered the rural market as well. In Glasgow, Montana and Hulbert, Oklahoma, we are the first to bring the national mortgage market to rural homebuyers and Native Americans. At Valley Bank in Glasgow -- a town of 4500 residents and over 4 hours from the nearest metropolitan area -- 7 loans were registered in the past month, totaling over $500,000 dollars. Without the latest technology, these markets could never be effectively served by the variety of desirable mortgage products and services.

I believe that programs like Residential Express and Community Home Buyer's that rely on new technology and build on institutions already serving the community, are the kind of partnerships which should be encouraged by Congress and the Administration.

We at GE Capital Mortgage are aware that controversy has developed concerning the rules for operating computerized loan origination systems. I am not a lawyer or a RESPA expert, but rather a business man and mortgage banker. And we have not been involved in the forefront of the regulatory debate regarding RESPA and CLOs. This is not to say we are not interested in how these issues are resolved, but until now our focus has been on the development and application of new technology.

From our own experience, I can tell you that this technology has the potential to bring immense benefits to many homebuyers in all areas across the nation. This is especially true in underserved urban and rural areas. CLOs can provide homebuyers the means to access the national mortgage credit capital markets in ways which are as sophisticated as any available to homebuyers in upper income neighborhoods. Our experience leads us to believe that this may be a significant piece in the community reinvestment puzzle which the Congress and we in the private sector have been trying to put together for a long time.

It is important that this technology not be prematurely circumscribed by rules which may be designed to protect against abuses more imagined than real. We think that HUD was correct when it stated in the preamble to its RESPA regulations that there are "....potentially substantial consumer benefits in the utilization of new technology. Further, the technology was in flux and represented, at most, no more than one to two percent of mortgage originations annually. Considering all of these factors HUD concluded that it would issue a CLO exemption....which would have the effect of eliminating possible regulatory inhibitions on the development of this technology."

We are now reaching out to underserved markets through Residential Express services available at minority-owned and community banking financial institutions. But in the future, we may utilize this technology with nonprofits groups, or majority or minority-owned real estate companies. Please don't close off these avenues to bring mortgage services to innercity and rural families and indeed to all homebuyers. We believe that the speed, convenience and cost savings associated with computerized loan origination are too important to be lost in an intramural turf battle among settlement service providers.

Mr. Chairman, our experience has taught us three important lessons. First, no single entity can provide the entire solution to the problems of these underserved communities. It takes the collective strength of all of us -- government at all levels, non-profits, community groups and the private sector, working in partnership.

Second, it is essential to link underserved neighborhoods to the mainstream community. We at GE have been a link -- providing knowledge, the latest technology, and access to capital.

Third, in order to be successful, these programs must be good and profitable business. Only commercially viable efforts will sustain the large infusion of private sector capital -- the big dollars -- needed over the long term.

If we apply these lessons to residents and businesses in economically underserved communities, I am confident that we will makes good progress in bringing these neighborhoods into the economic mainstream of society.

Mr. Chairman and members of the Committee, I appreciate the opportunity to testify on these important programs and would be pleased to answer any questions you may have.

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